

# Presentation to the California Debt and Investment Advisory Commission

Credits under Stress

Political Risk in Times of Austerity

How States and Investors Can Deal with the  
Willingness to Pay vs. Inability to Pay Problem

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# I. Historical Question of Political Risk in Times of Austerity

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- I. Historically, while political risk of non-payment was a possibility, it was a rare occurrence, if not in reality a non-existent concern, with a few exceptions (*i.e.* Repudiation of Civil War related debt by 13 states in the late 1800's, Washington Public Power Supply System, 1983).
  - A. Historically, there is a low default rate for bonds issued by municipalities and states:
    - 1. Dr. John Peterson of George Mason University noted in his recent paper on “Municipal Defaults: Eighty Years Made a Big Difference” (2011) that, between 1970's-2000's, the municipal default rate for municipalities averaged per decade .10% to .24% (adjusted for WPPSS and Jefferson County, Alabama) not including the fact that over 80% of the defaults were conduit financings and not essential public financings. This is a far cry from corporate bond default rate on average for investment grade and non-investment grade of about 10%.

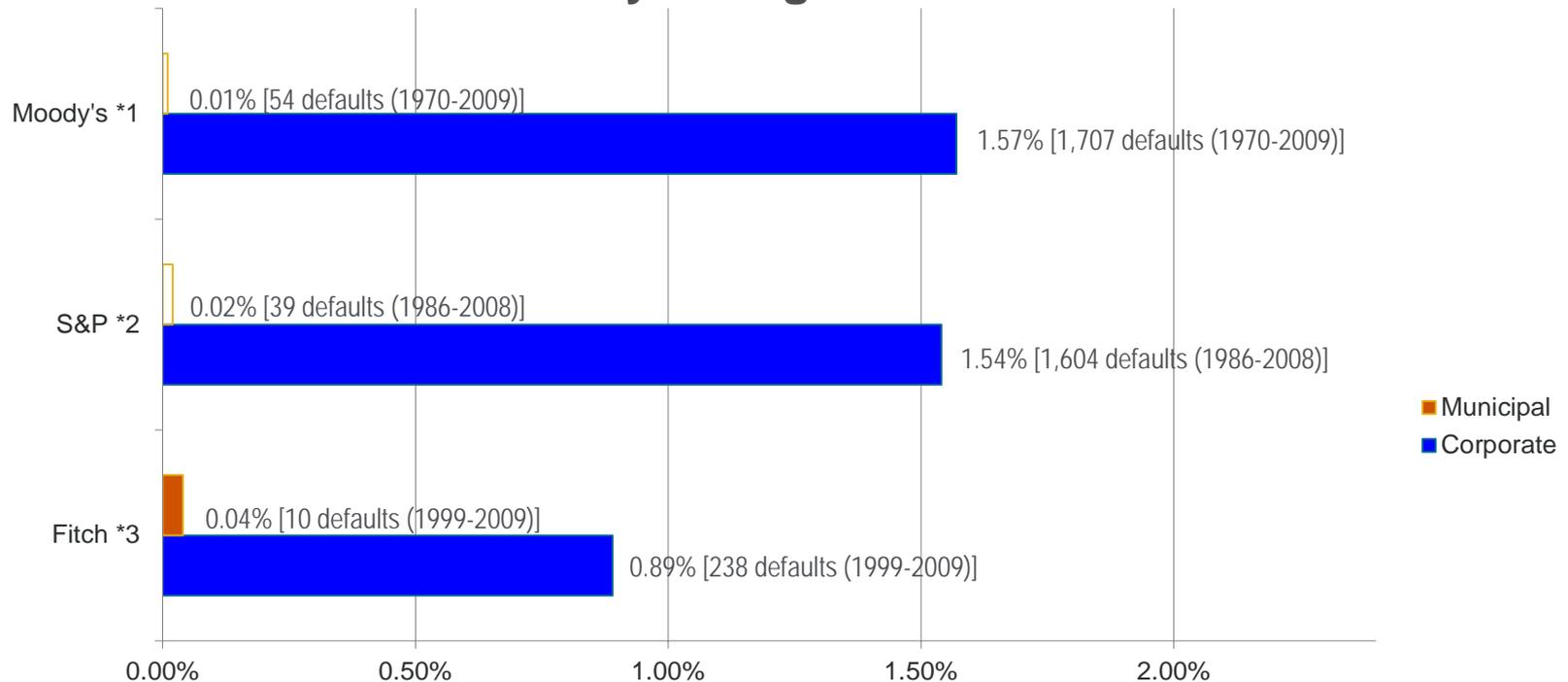
# I. Historical Question of Political Risk in Times of Austerity

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2. States have not defaulted on general obligations bonds since the late 1880's, with the exception of Arkansas in 1933, which was thereafter refinanced.
3. Historically, based on default rate, there is little support for the willingness to pay to be deemed a real problem since there is an absence of political risk.

# I. Historical Question of Political Risk in Times of Austerity

## Rated Municipal vs. Corporate Default Rates by Ratings Service



1. Moody's Investors Services, U.S. Municipal Bond Defaults and Recoveries, 1970-2009 (February 2010); Moody's Investors ServCorporate Default and Recovery Rates, 1920-2009 (February 2010). Percentages based upon average one-year default rate.
2. Standard & Poor's, 2009 Global Corporate Default Study and Ratings Transitions (March 17, 2010); Standard & Poor's; U.S. Municipal Ratings Transitions and Defaults, 1986-2009 (March 11, 2009). Percentages based on average default rate.
3. Fitch Ratings Inc. U.S. Public Finance Transition and Default Study (1999-2009), March 25, 2010; Fitch Ratings Global Corporate

# I. Historical Question of Political Risk in Times of Austerity

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- B. Historically the use of bankruptcy by a municipality does not support any fear of political risk:
  - 1. Unlike corporations local governments rarely use Bankruptcy, Chapter 9 – generally only special tax districts and small municipalities file. No large issuers of municipal debt (with the exception of Orange County, California in 1994, Bridgeport, Connecticut in 1991, Vallejo, California in 2008, Jefferson County in 2011, Stockton, California in June, 2012 and San Bernardino, California in August, 2012) have filed in the last 30 years. There have been only 642 Chapter 9 filings since 1937. In 2008, 2009, 2010 and 2011 there were 4, 10, 6 and 13 respectively, municipal Chapter 9 filings. So far this year there have been 11 Chapter 9 filings of which only 3 have been cities, towns or counties (Stockton, Mammoth Lakes and San Bernardino). There were 58,721 business (14,745 Chapter 11) filings in the year ending September 30, 2009 and 58,322 business bankruptcy (14,191 Chapter 11) filing in the year ending September 30, 2010.

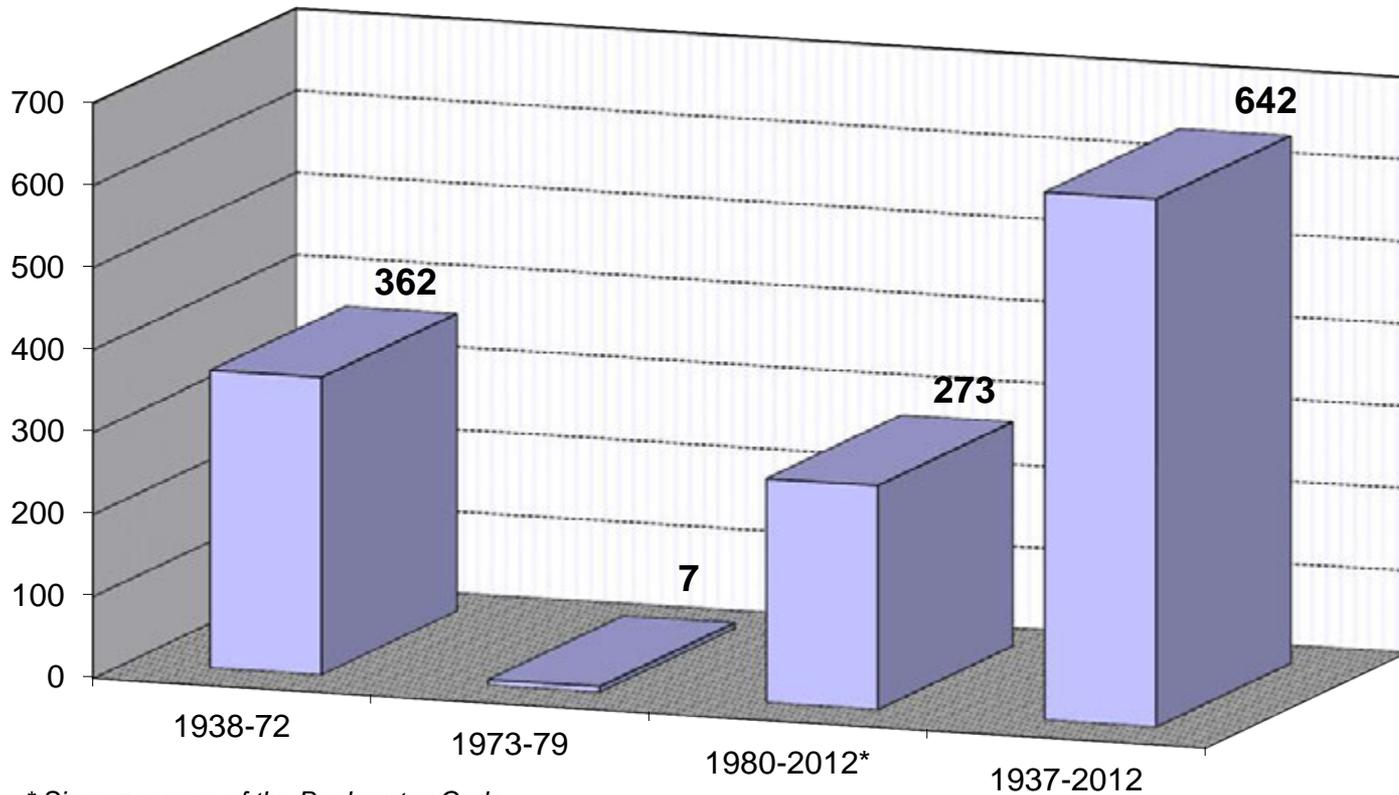
# I. Historical Question of Political Risk in Times of Austerity

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2. Comparing Chapter 11 corporate reorganization filings to Chapter 9 municipal debt adjustment filings reveals the historical strength, willingness to pay and credit quality of municipal bond debt. In 2009 and 2010, there were over 14,000 Chapter 11 corporate reorganizations filed each year. Since 1937, there have only been 642 Chapter 9 cases filed, most of which have been small special tax district and entities that did not issue municipal bonds.
3. Further, of the 642 Chapter 9 municipal bankruptcy filings since 1937, 163 or 25% have been dismissed or closed without a plan of adjustment filed. Since 1980, there have been 267 Chapter 9 filings by municipalities and, of those, 84 or 30% have been dismissed or closed without a plan and only 52 of the 273 have been traditional local governments (town, cities, villages and counties).

# Default Statistics

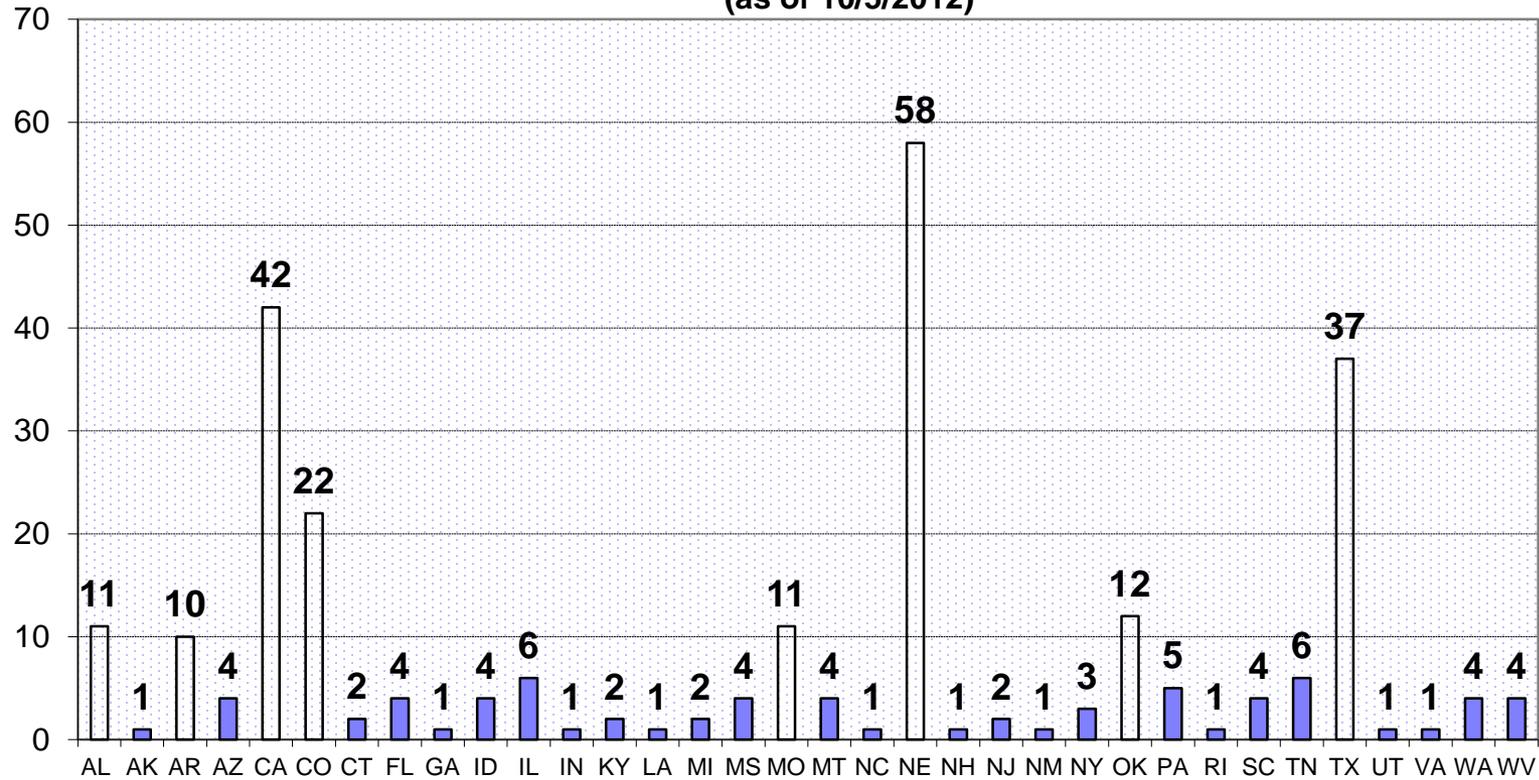
## FREQUENCY OF MUNICIPAL BANKRUPTCIES • 1937-2012 (as of 10/5/2012)



\* Since passage of the Bankruptcy Code.

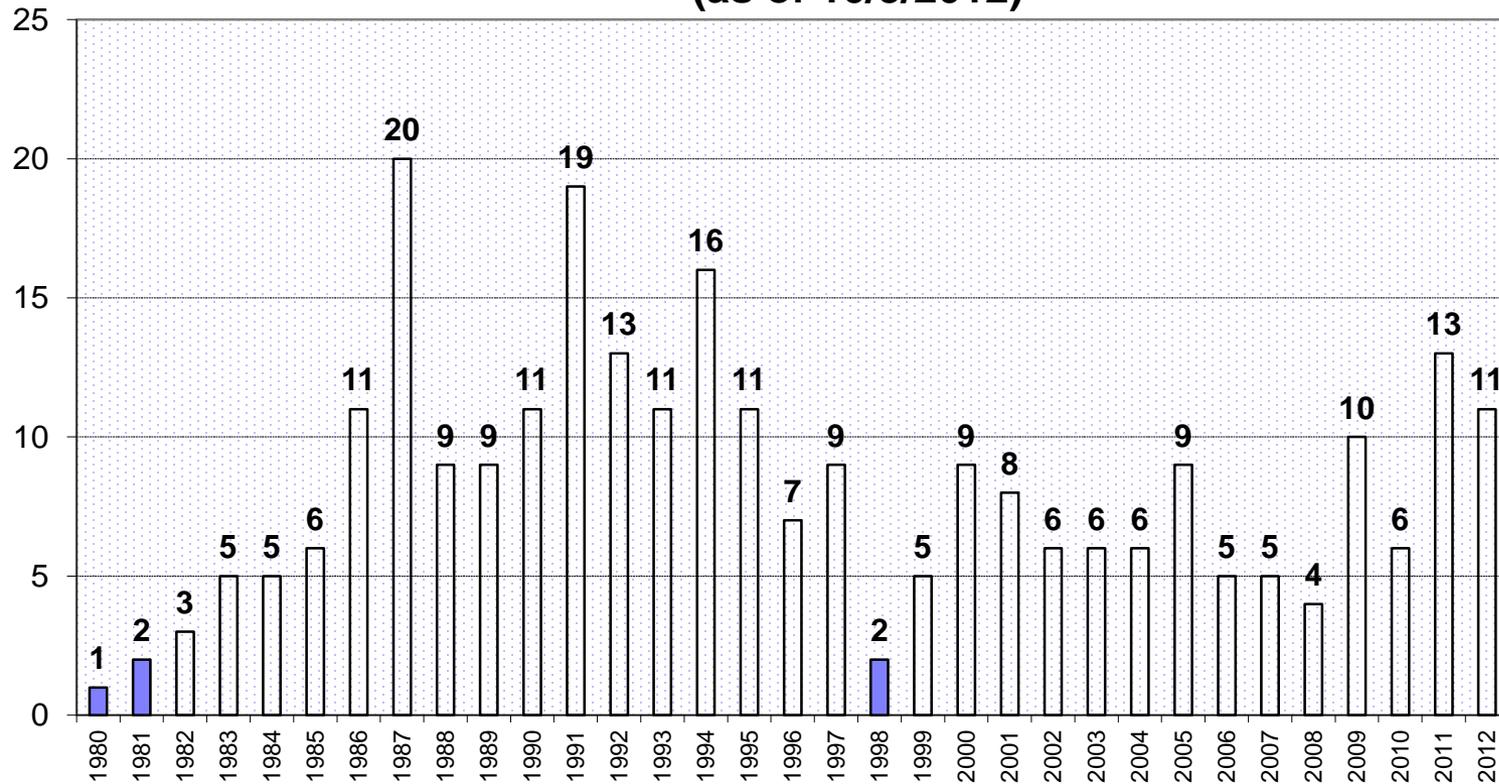
# Default Statistics

**CHAPTER 9 FILINGS BY STATE • 1980-2012**  
(as of 10/5/2012)



# Default Statistics

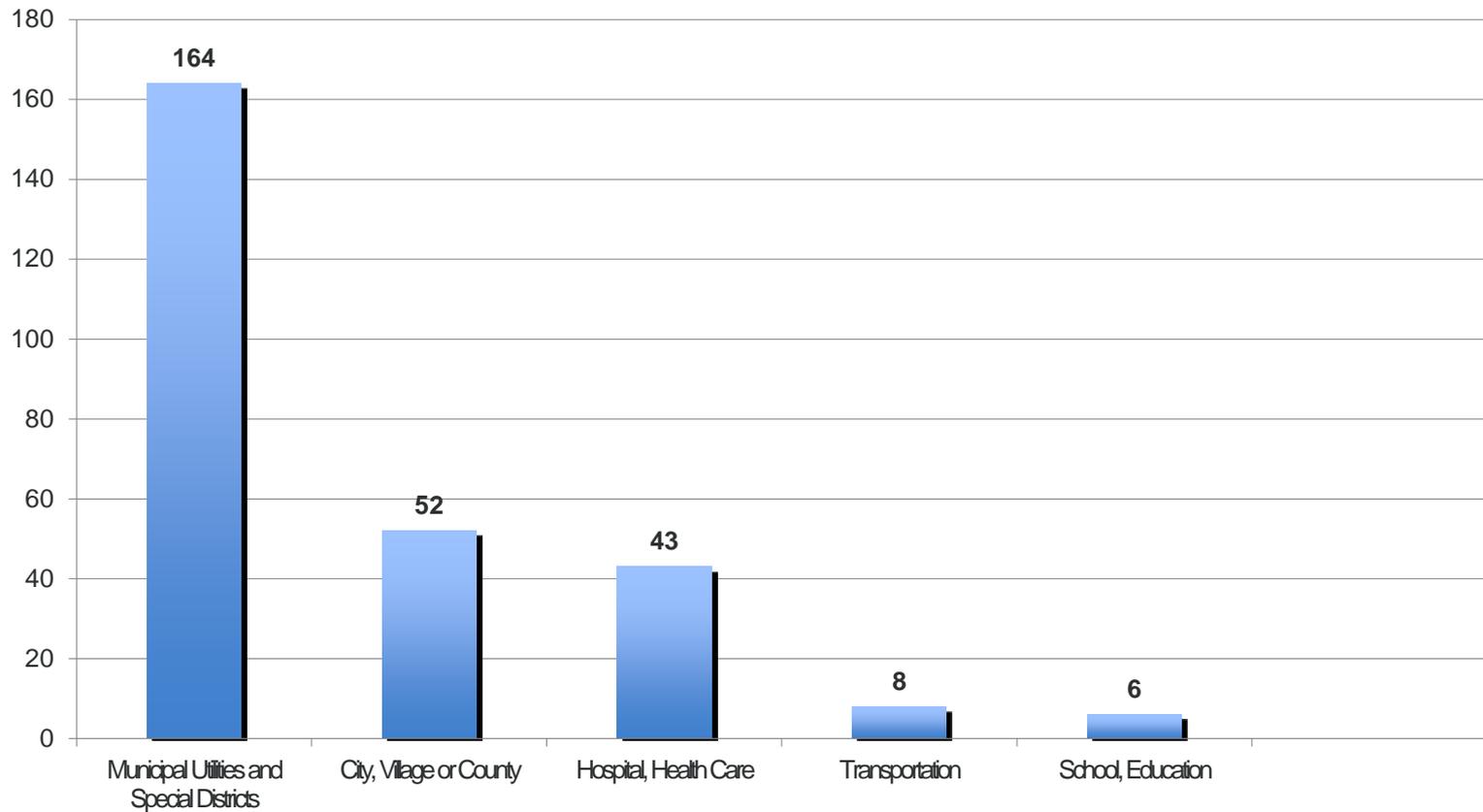
**CHAPTER 9 FILINGS BY YEAR • 1980-2012**  
**(as of 10/5/2012)**



# Default Statistics

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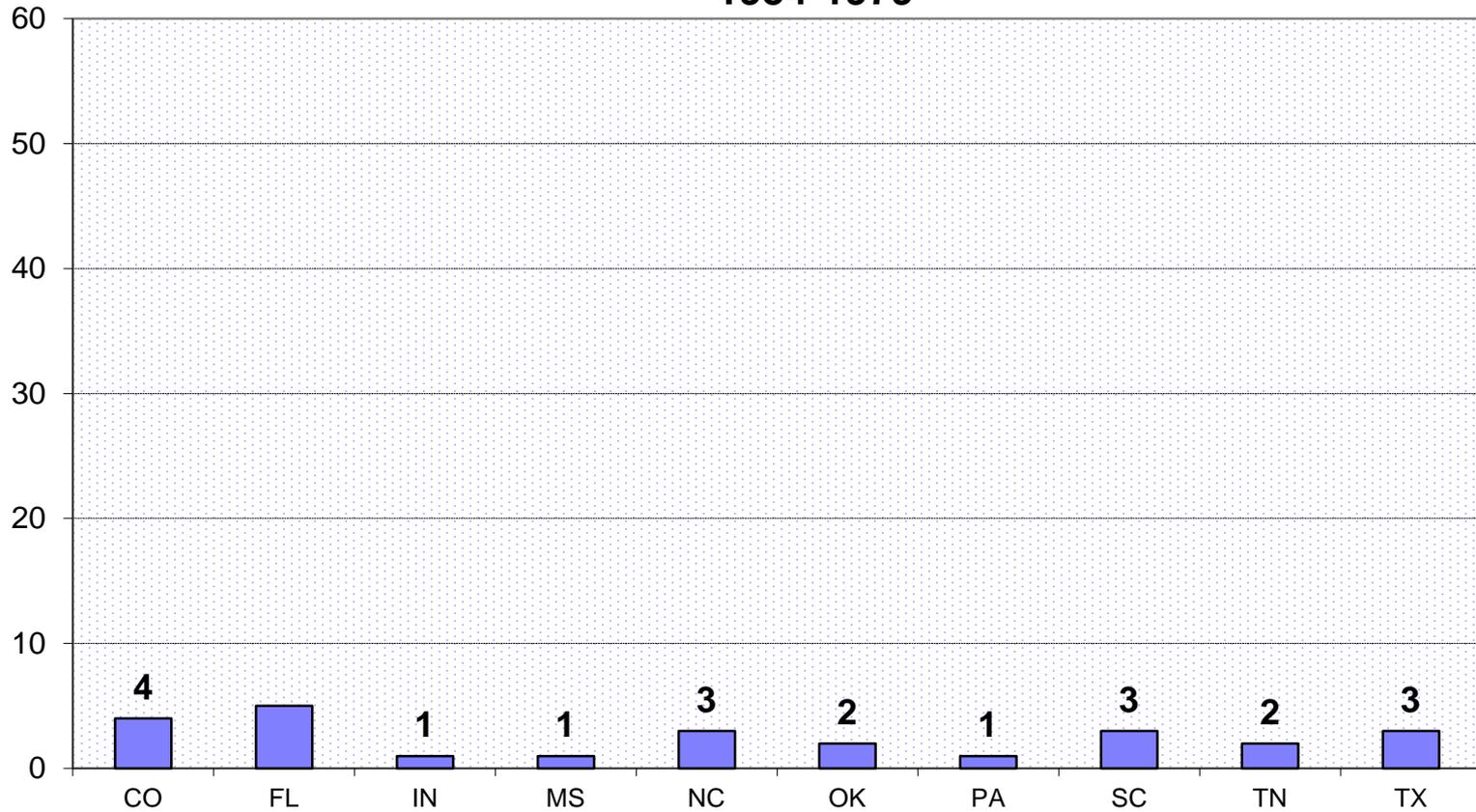
## CHAPTER 9 FILINGS BY TYPE • 1980-2012 (as of 10/5/2012)



# Default Statistics

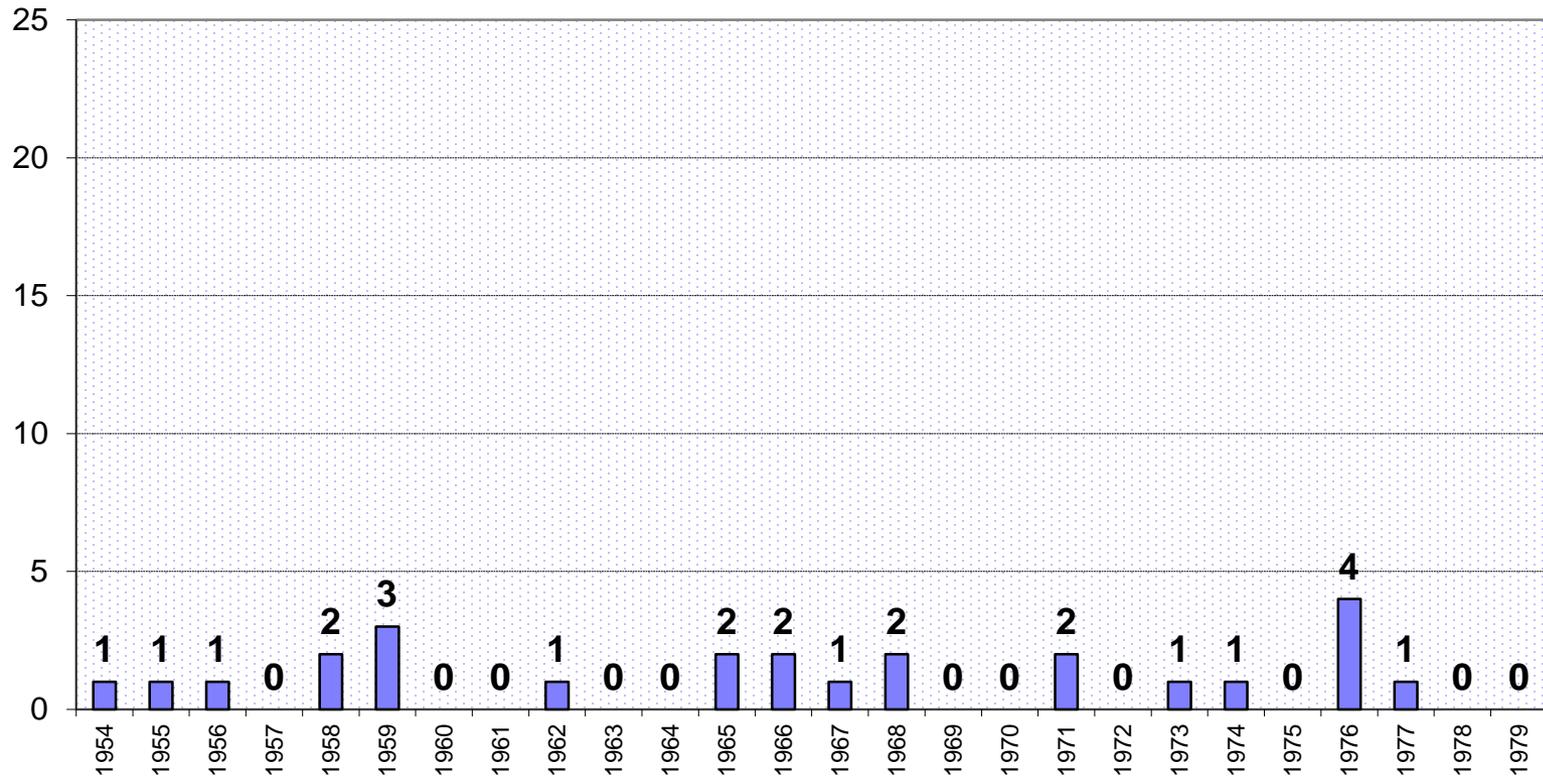
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**MUNICIPAL BANKRUPTCY FILINGS BY STATE  
1954-1979**



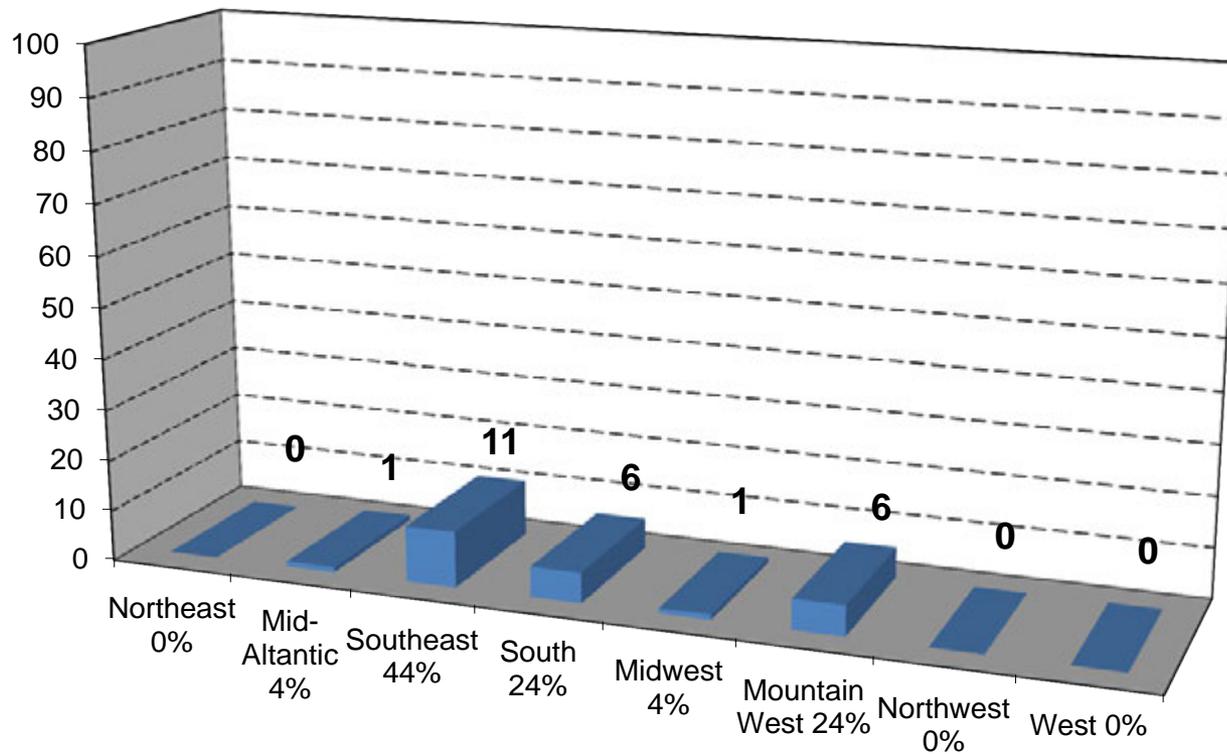
# Default Statistics

**MUNICIPAL BANKRUPTCY FILINGS BY YEAR  
1954-1979**



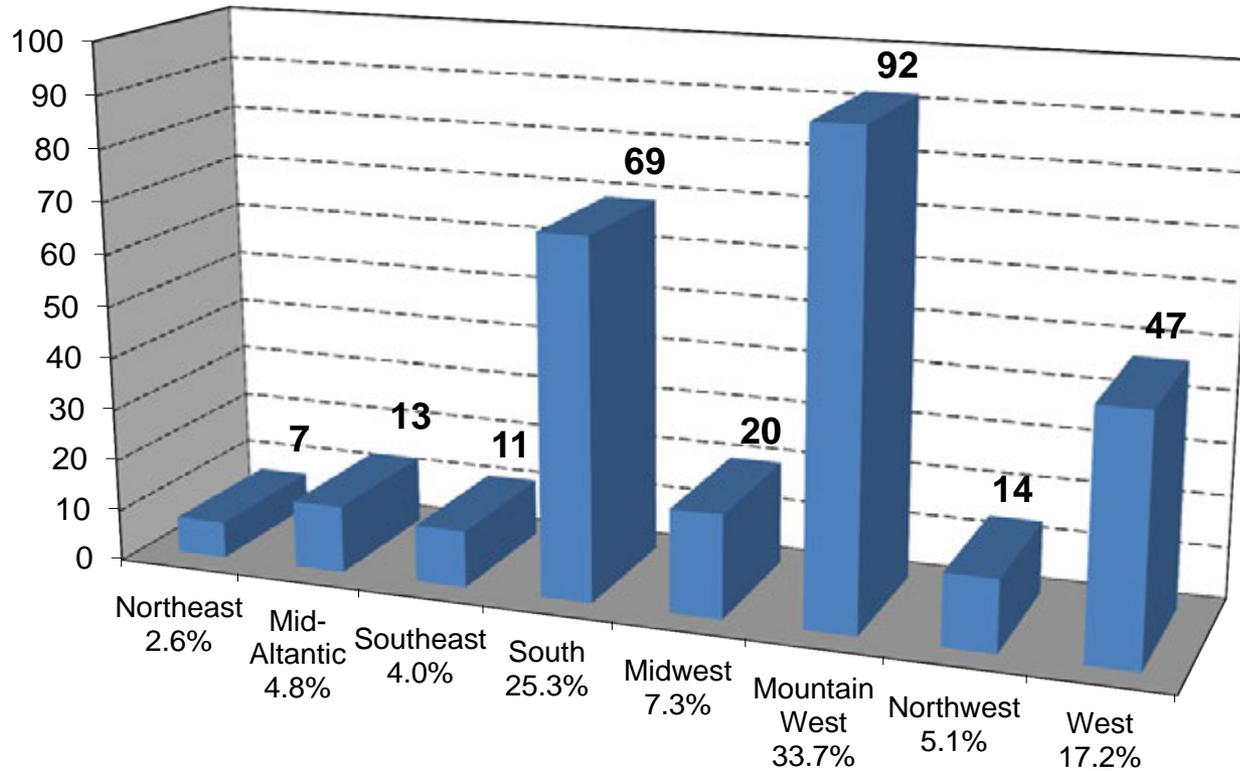
# Default Statistics

## MUNICIPAL BANKRUPTCIES BY REGION 1954-1979



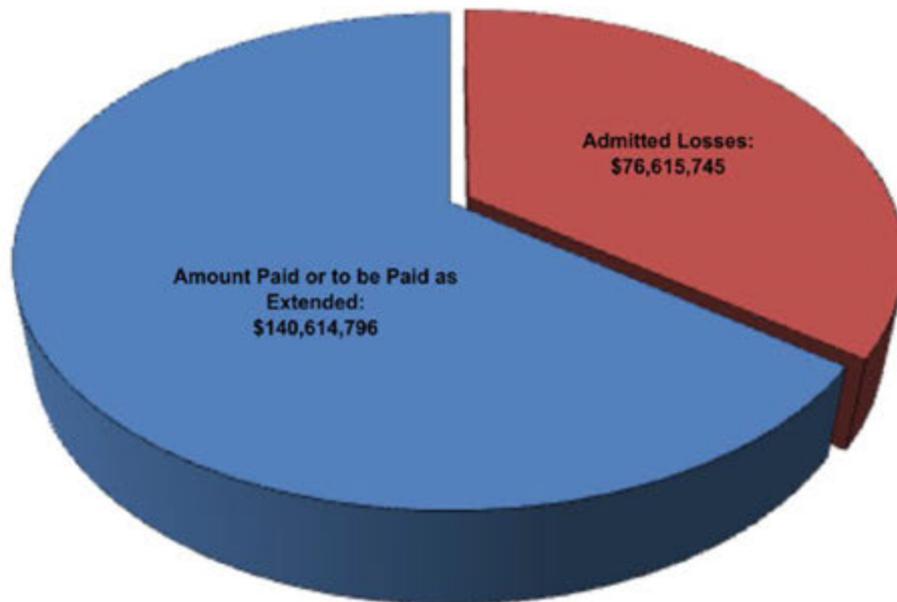
# Default Statistics

## CHAPTER 9 FILINGS BY REGION • 1980-2012 (as of 10/5/2012)



# Default Statistics

## MUNICIPAL BANKRUPTCY RECOVERY 1938-1972\*



Total Cases Filings:	362
Total Cases Dismissed:	79
Total Cases Still Pending 1972:	10
Total Cases Concluded:	273
Aggregate Admitted Debts	\$217,230,541
Average Debt Per Filing of Cases Concluded:	\$795,716
Average Percentage Recovery on Cases Concluded:	64.7%

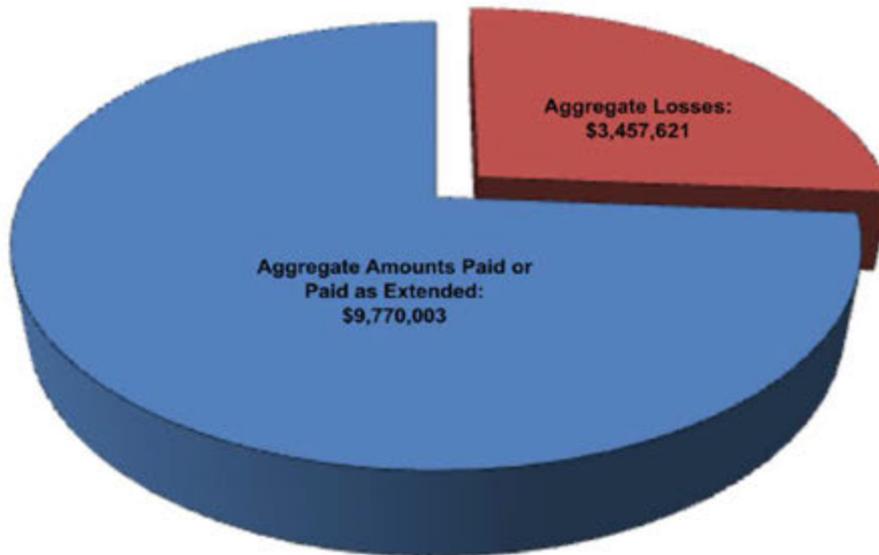
\* See Table 5-1, *City Financial Emergencies: The Intergovernmental Dimension*, Advisory Commission on Intergovernmental Relations, July 1973.

# Default Statistics

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## MUNICIPAL BANKRUPTCY RECOVERY 1954-1972\*

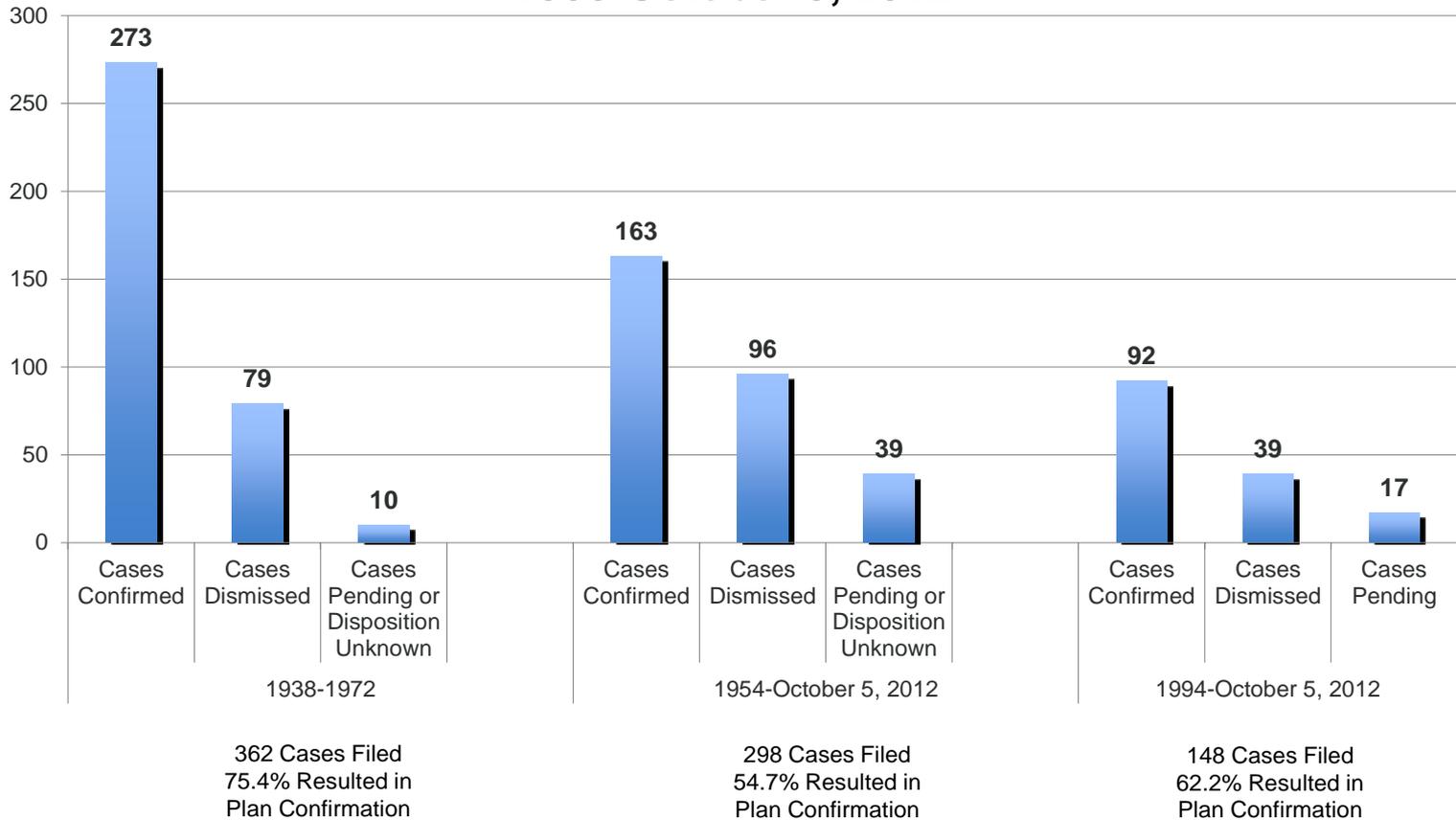
Total Filings:	18
Aggregate Admitted Debts:	\$13,227,624
Average Debt Per Filing:	\$734,868
Average Percentage Recovery:	73.4%



\* See Table 5-1, *City Financial Emergencies: The Intergovernmental Dimension*, Advisory Commission on Intergovernmental Relations, July 1973.

# Default Statistics

## DISPOSITION OF CASES 1938-October 5, 2012



# I. Historical Question of Political Risk in Times of Austerity

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- C. Traditionally causes of municipal Bond Defaults in the U.S.A have been linked to inability to pay rather than unwillingness to pay or political risks:
1. Economic Depression.
  2. Non Essential Services.
  3. Feasibility of Projects and Industries.
  4. Fraud.
  5. Mismanagement.
  6. Unwillingness to pay.
  7. Natural and Man Made Disasters.

# I. Historical Question of Political Risk in Times of Austerity

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D. Current Potential Causes of Municipal Default. Generally, 75% of all municipal bond defaults have occurred in bonds issued by municipalities to finance revenue producing enterprises (*i.e.*, highways, bridges, utilities, swimming pools, harbors, etc.). General Obligation Bonds have been 25% or less of defaults.

There are many causes of municipal default. A number of factors, while they do not in and of themselves necessarily cause default, contribute to restricted cash flow which brings about an inability to meet scheduled debt service payments.

1. Unaffordable and Unsustainable Personnel Costs.
2. Deferred Costs of Capital Improvements and Infrastructure Costs.
3. Recent and Unaddressed Natural Disasters of Manmade Disasters.
4. The Bursting of USA State and Local Government Debt Bubble.
5. Decline of Urban Areas.
6. Flight from the Rustbelt to the Funbelt.
7. Proposition Thirteen Mentality – The Popularity of Tax Caps and Limitations.
8. Lingering Legal Issues and Surprise Court Decisions.
9. Off Balance Sheet Liabilities.
10. Airports, Casinos and Sport Stadium.
11. Willingness to Pay vs. Ability to Pay – Willingness to pay traditionally has not been a problem but could be a growing problem.

# I. Historical Question of Political Risk in Times of Austerity

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- E. Since the Depression of the 1930's, States and Local Governments have diversified the source of tax revenues to reduce reliance on property taxes and to spread the burdens and reduce the risk of concentration.

# Changes in the Source of State and Local Governments Revenues (1922-2008)

## General State and Local Governments Revenues 1922-2008: Totals and Percentage Distribution

	1922	1927	1932	1936	1940	1968	2008
Amount of Gen. Rev. (billions of dollars)	4.8	7.3	7.3	8.4	9.6	101.3	2425.8
Percent Distribution							
Property Tax	69.5	65.1	61.7	48.8	46.1	27.4	16.7
Sales Tax	3.2	6.5	10.3	17.7	20.6	22.6	18.5
Income Tax	2.1	2.2	2.1	3.2	4.0	9.7	14.8
Other Tax	9.2	10.0	10.6	10.2	10.6	7.0	4.5
Misc. Rev.	13.7	14.7	12.0	8.9	8.9	16.3	25.7
Federal Aid	<u>2.3</u>	<u>1.6</u>	<u>3.2</u>	<u>11.3</u>	<u>9.8</u>	<u>17.0</u>	<u>19.8</u>
<b>TOTAL</b>	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bureau of the Census – John Petersen "Municipal Defaults Eighty Years Makes a Big Difference 5/21/11" p. 9 George Mason University

- Property, income and sales taxes made up over 70% of state and local governments revenues in 1922-1940 but only 50% of state and local governments revenue by 2008. More diverse and varied tax base in 2008 with more federal assistance.
- Property taxes which made up over 60% of the revenues of state and local governments between 1922-1932 was only 16.7% of revenue by 2008 with increases in sale, income other, miscellaneous and federal aid making up the difference.

# I. Historical Question of Political Risk in Times of Austerity

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We presently are recovering from a significant economic downturn:

- With unemployment hovering above 8% for many months, state and local governments will feel the effects of the following:
  - Lower Sales Tax Collection.
  - Lower Real Estate Tax Collection.
  - Lower Personal Income Tax Collection.
- We all have seen this before and, in the past, issuances of state and local government debt financing have helped stimulate increased employment and economic growth.

Remember the Industrial Revenue Bonds, Recovery Zone Economic Development Bonds and other forms of financing and all of their efforts to increase business opportunities on the state and local level have successfully led to past recoveries. Other similarly related state and local government financing may this time be just what is necessary to encourage economic growth and job creation.

# I. Historical Question of Political Risk in Times of Austerity

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- G. Historically, government finance officers did anything they could to avoid default due to the essential need of any government of size to access the municipal market to cover financing of infrastructure and essential services at a low cost:

Municipalities and states fear default would lead either to limited or no access to the Municipal Bond Market or significant increase in the cost of borrowing (increased interest costs). This would limit or deprive states or municipalities of their present ability to decide locally what infrastructure improvement or what essential services they will finance and to finance such themselves rather than to obtain the consent or approval of a higher government who has the ability to obtain financing and possibly a different agenda.

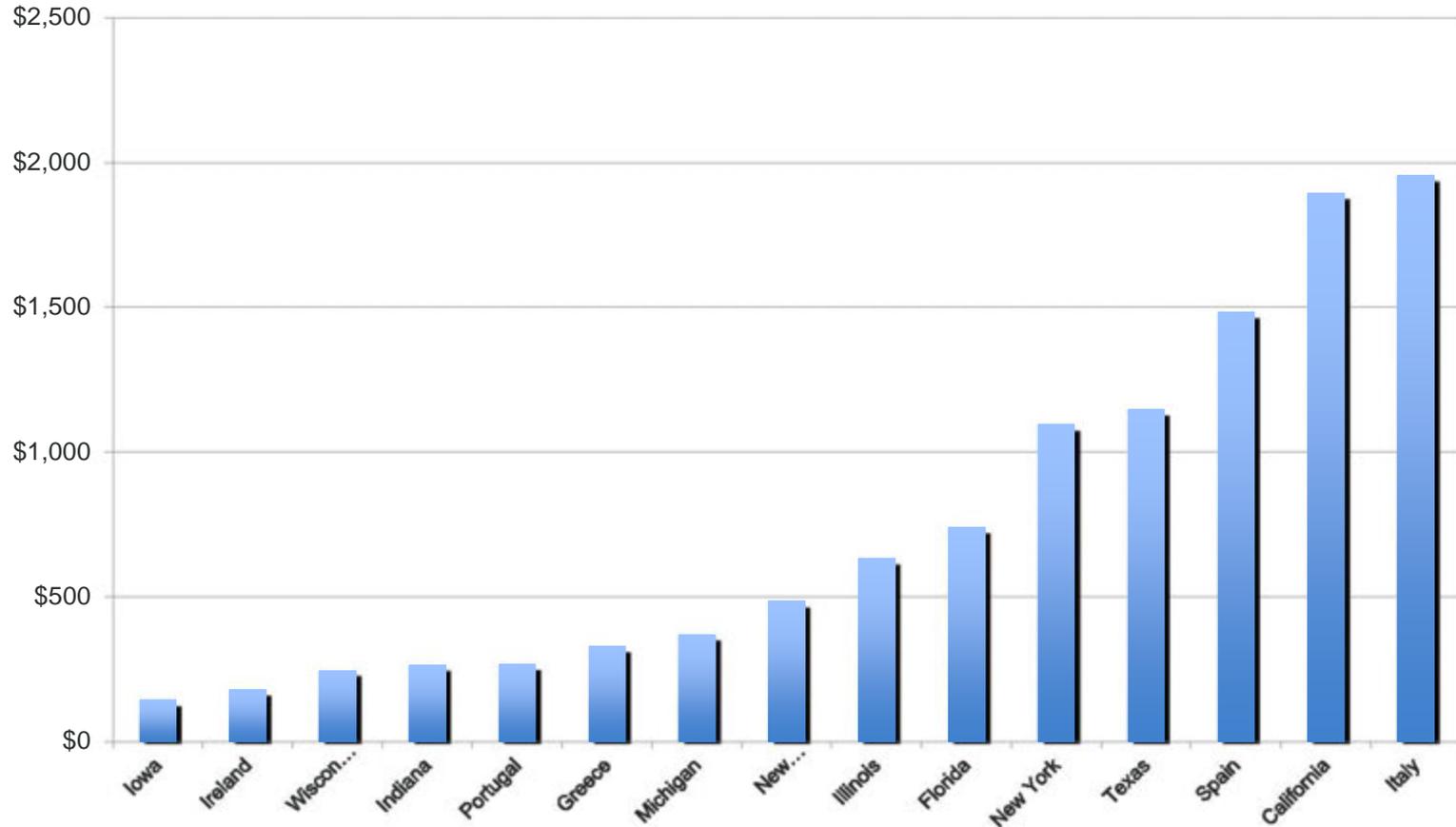
# I. Historical Question of Political Risk in Times of Austerity

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- H. Our states enjoy a favorable GDP and Debt to GDP and Debt to Revenue Ratios compared to other Sovereigns on a global basis.
- Will any U.S. state become the next Greece, Ireland, Portugal, Spain or Italy, one of the PIIGS?
    - The per capita GDP of each of California, Texas, Florida, New York, Illinois and New Jersey (certain “Major U.S. States”) is higher than Portugal, Greece, Italy and Spain.
    - The percentage of debt to revenue ratio is lower for Major U.S. States than Portugal, Italy and Greece.
    - The percentage of debt to GDP is lower for certain Major U.S. States than Spain, Ireland, Portugal, Greece and Italy.
    - Market perception can be different than reality. Look at Credit Default SWAPs (“CDS”) for certain Major U.S. States and the PIIGS, where Italy, Spain, Ireland, Portugal have lower CDS spreads than New Jersey, New York, California and Illinois.

# GDP of Selected U.S. States and European Countries

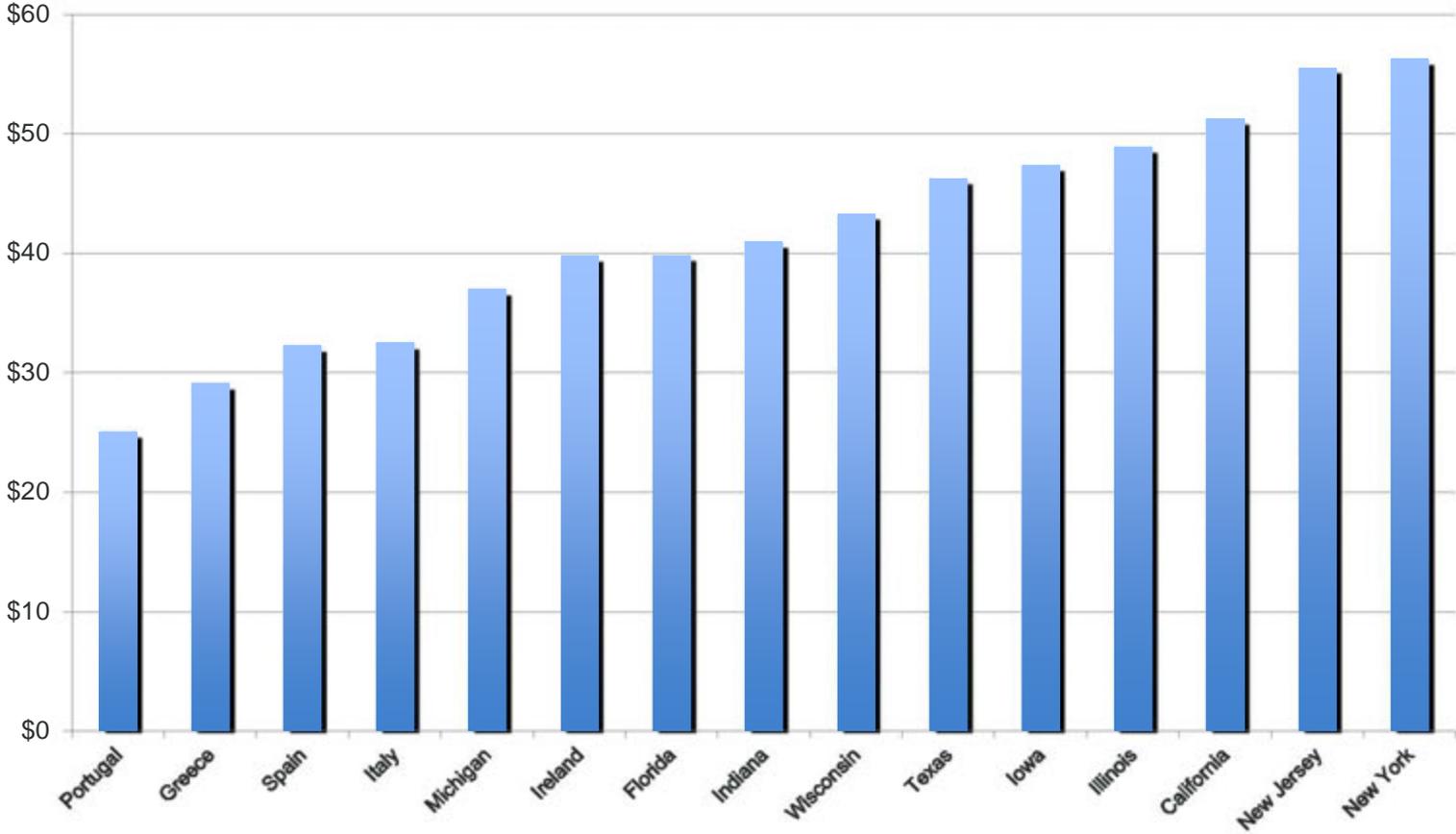
## Billions of 2009 USD



Source: US Bureau of Economic Analysis; OECD.

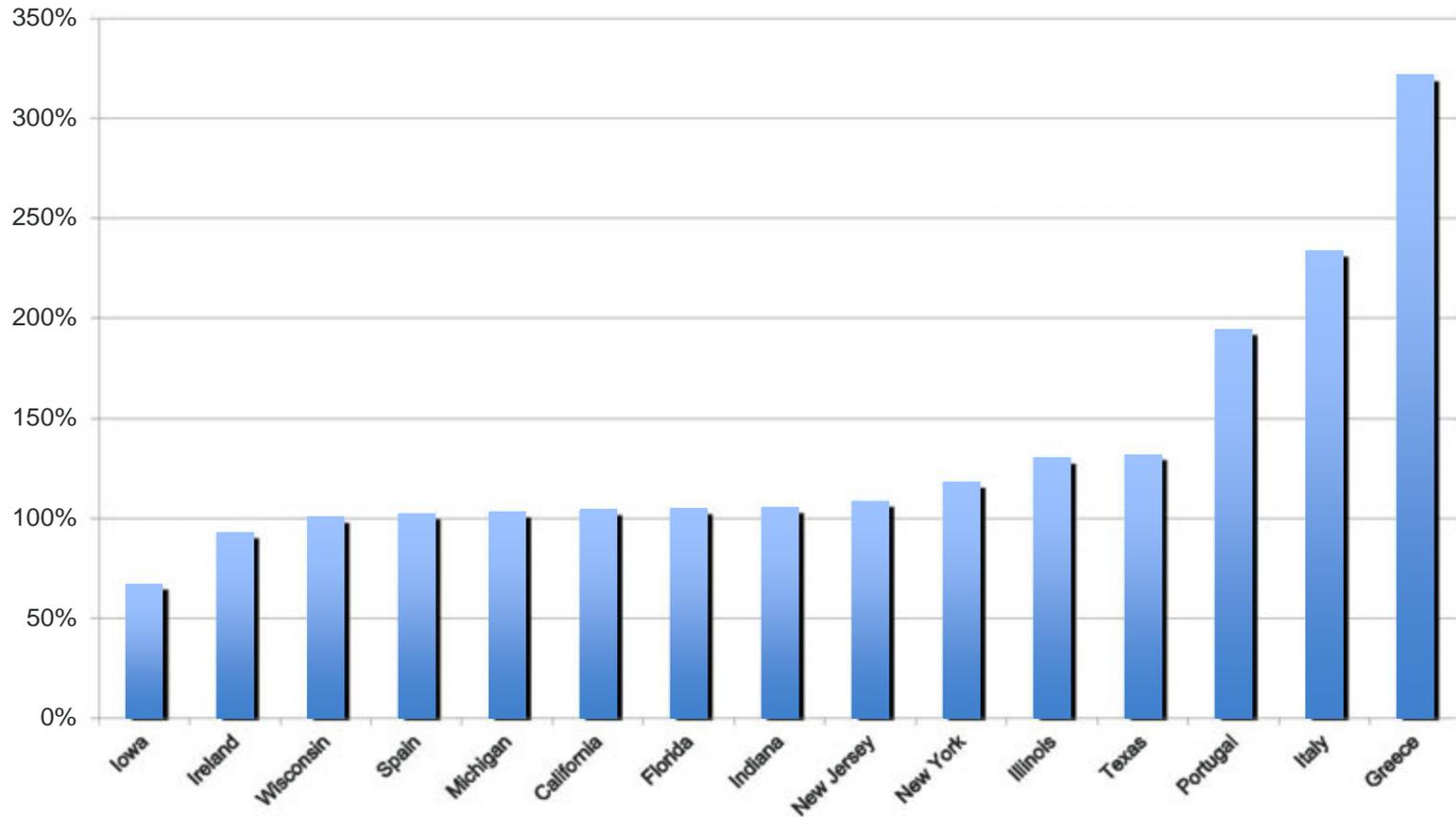
# GDP per capita of Selected U.S. States and European Countries

## Thousands of 2009 USD



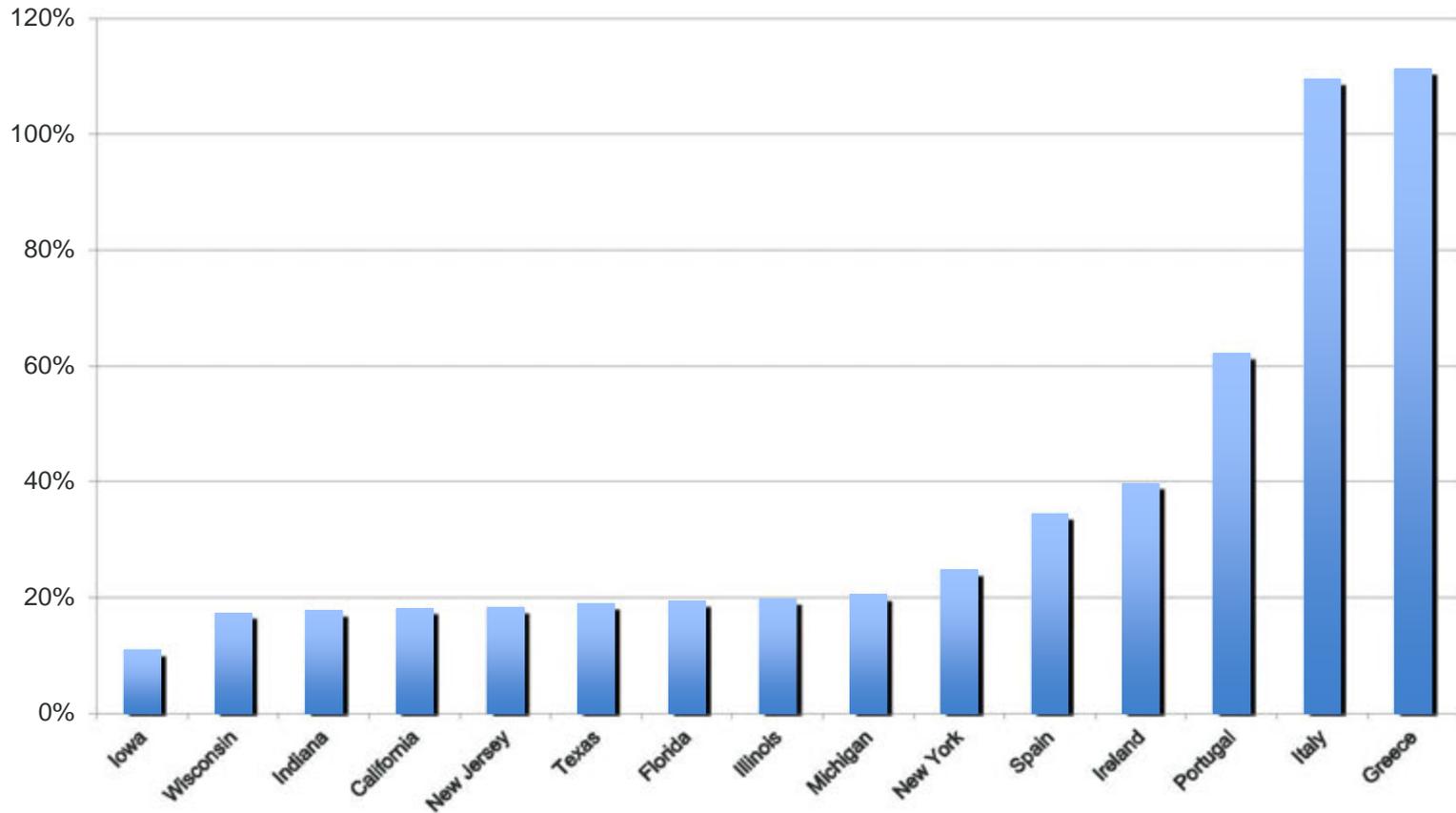
Source: US Bureau of Economic Analysis; US Census Bureau; OECD.

# Debt-to-Revenue Ratio of Selected U.S. States and European Countries (2008 figures)



Source: US Bureau of Economic Analysis; US Census Bureau; Eurostat; OECD.

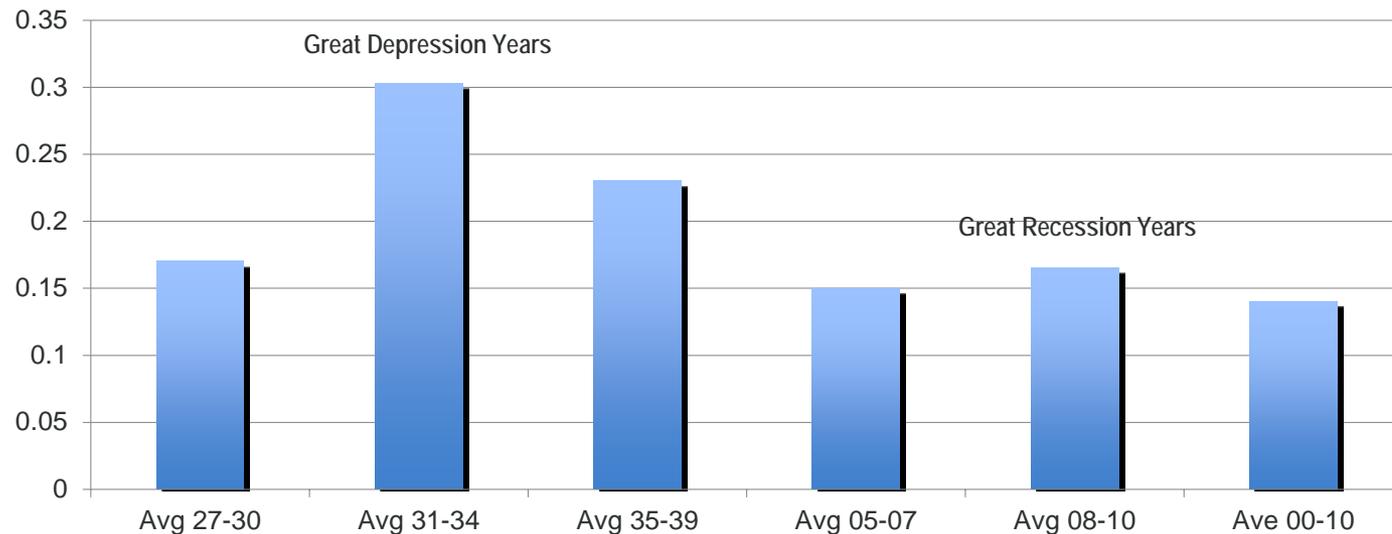
# Debt-to-GDP Ratio of Selected U.S. States and European Countries (2008 figures)



Source: US Bureau of Economic Analysis; US Census Bureau; Eurostat; OECD.

# State and Local Governments Debt to GDP Percentage Has Improved from that of the Great Depression

**Ratio of State-Local Debt to GDP: Late 1920s, 1930s, and 2000s**



Source: John Petersen: "Municipal Defaults Eighty Years Makes a Big Difference 5/21/11" p. 16 George Mason University

- Even much talked about individual states (such as California, Illinois, Michigan, New Jersey, New York and Texas) have GDP to Debt Ratios significantly lower than the 30% average during the Great Depression years.
- The current trend is reduced borrowing and debt issuance by state and local governments.

# I. Historical Question of Political Risk in Times of Austerity

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- I. Selected Case Studies of Past Financial Emergencies of Municipalities
  1. The New York and Cleveland Experiences (Problems of Financial Controls and State and Federal Bailouts).
  2. The San Jose School District and Medley, Florida Cases (Excessive Labor Costs or Judgments).
  3. Washington Public Power Supply System (Projects Fail When Expected Demand Evaporates).
  4. The Colorado Special Districts (Failed Special Projects).
  5. City of Bridgeport, Connecticut (City Troubled by Flights of Population and Business and the Use of Intercept).
  6. City of Philadelphia (Successful Legislation and State and Local Cooperation Avoid Disaster).
  7. Orange County, California (Creative Financing to Solve Tax Revenue Shortfalls).

# I. Historical Question of Political Risk in Times of Austerity

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- J. Recent Examples of Financial Emergencies of Municipalities (These will be discussed in more detail in the Lessons Learned section).
  1. City of Vallejo, California (The consequences of too rich benefit programs.)
  2. Central Falls, Rhode Island (Bondholders come first.)
  3. Harrisburg, Pennsylvania (Eligibility.)
  4. Jefferson County, Alabama (The scope of special revenues.)
  5. Stockton, California (The use of neutral evaluator in California.)
  6. San Bernardino, California (The importance of sufficient cash on hand and liquidity for municipalities.)
  7. Atwater, California (Are there alternative methods of dealing with liquidity issues and unsustainable and unaffordable labor costs?)

## II. State Provisions Regarding Government Debt Default Prevention

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### A. Use of Debt Limitation and Tax Limitation:

1. All states except Tennessee impose some sort of limitation on the Amount of Debt:
  - Florida and Alaska have some indirect control on debt, *i.e.* Alaska has a limit on taxes that a municipality can levy – ad valorem taxes in excess of 3 percent assessed value and Florida has limitation on ad valorem taxes to finance or refinance capital projects – requires voter approval.
2. Municipal Debt limits range from a percentage of a valuation of assessed property to a monetary amount.

## II. State Provisions Regarding Government Debt Default Prevention

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3. States handle debt for essential services differently than non essential:
  - Arizona – 15% limit with voter approval for nonessential 20% for essential.
  - Kansas – Bonds for sewer systems to acquire or enlarge municipal utility and street improvement not counted in debt limitation.
  - Idaho – 2/3 voter approval to exceed limitation.
  - Puerto Rico – Limits may not be less than 5 percent or greater than 10 percent aggregate tax valuation of property in a municipality.
  - Rhode Island – Debt limit but measured net of tax anticipation bonds and amount of any sinking fund.

## II. State Provisions Regarding Government Debt Default Prevention

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4. There have been recent attempts in some States to tighten local debt limits while others strengthen protections:
  - Colorado 2010 – Amendment to greater limit the ability of local government to borrow funds was defeated by 73%.
  - Rhode Island 2011 – Payment of Bond debt will have first priority lien on revenues of a municipality in order to assure the municipal market of the dedication to payment so that access and cost of financing not threatened.

## II. State Provisions Regarding Government Debt Default Prevention

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5. Generally Revenue Bonds paid from the revenues of a municipal enterprise (water, sewer, bridge, tollway, electric system) are exempt from debt limits. So also are the tax increment financing and appropriation bonds.

## II. State Provisions Regarding Government Debt Default Prevention

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### B. Refunding Bonds are permitted in all States:

- Every State provides some form of Refunding Bonds.
- Refunding Bonds provide the ability and the benefit of refunding high interest rate debt in a low interest market.
- States place restrictions on the extent and purpose of the refunding such as:
  - to reduce debt service,
  - eliminate restrictive covenants,
  - to pay bond and note anticipation obligations, and
  - to adjust lease rentals.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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- A. At least twenty-three States have implemented some form of municipal debt supervision or restructuring mechanism to aid municipalities:
- These range from Debt Advisory Commissions (*e.g.* California) and Technical Assistance Programs (Florida) which provide guidance for and keep records of issuance of municipal debt to the layered approach of Rhode Island and Michigan of oversight, commission and fiscal manager or receiver.
  - Examples of State Oversight, Supervision and Assistance for Fiscal Emergencies of Local Government.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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	<b>STATE</b>	<b>INTERVENTION PROVISION</b>
1.	Arizona	School District Receivership.
2.	California	Debt and Investment Advisory Commission.
3.	District of Columbia	Financial Responsibility and Management Assistance Authority.
4.	Florida	Bond Financial Emergencies Act; Division of Bond Finance and Local Government Financial Technical Assistance Program.
5.	Idaho	Debt Readjustment Plans.
6.	Illinois	Financially Distressed City Law; Financial Planning and Supervision.
7.	Indiana	Distressed Political Subdivision Protections and Township Assistance.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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	<b>STATE</b>	<b>INTERVENTION PROVISION</b>
8.	Kentucky	County Restructuring Provisions.
9.	Maine	Board of Emergency Municipal Finance.
10.	Massachusetts	<i>Ad hoc</i> State Intervention.
11.	Michigan	Emergency Financial Management and Local Government and School District Fiscal Accountability Act.
12.	Minnesota	Back-up Payment Procedures for Municipalities and School Districts.
13.	Nevada	Local Government Financial Assistance and Audit Enforcement Act.
14.	New Hampshire	Emergency Financial Assistance

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

	<b>STATE</b>	<b>INTERVENTION PROVISION</b>
15.	New Jersey	Local Government Supervision Act; Municipal Rehabilitation and Economic Recovery Act of 2002; Special Municipal Aid Act.
16.	New York	Emergency Financial Control Board; Municipal Assistance Corporation; New York Financial Control Board.
17.	North Carolina	Local Government Finance Act.
18.	Ohio	Fiscal Watch; Fiscal Emergency; Fiscal Emergencies and Financial Planning and Supervision Commission.
19.	Oregon	County Public Safety Emergency and Fiscal Control Board; Municipal Debt Advisory Commission.
20.	Pennsylvania	Financially Distressed Municipalities Act; Intergovernmental Cooperation Act.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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	<b>STATE</b>	<b>INTERVENTION PROVISION</b>
21.	Rhode Island	Fiscal Overseer; Municipal Receiver; Budget Commission.
22.	Texas	Municipal Receivership.
23.	Wisconsin	Deficiency Protection for Public Improvement Bonds.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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#### B. States recognize the use of a Municipal Receiver:

- The Rhode Island Experience and The City of Central Falls:
  - Overseers.
  - Budget Commission.
  - Receiver.
  - Chapter 9.
- Texas' use of judicially appointed Receiver vs. Financial Control Board, emergency financial managers, coordination overseers and Refinance Authorities.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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#### C. Financial Control Boards and Active Supervision

##### Examples:

- The New York Experience.
- The Pennsylvania Experience.
- The Michigan Experience.
- The Massachusetts *Ad Hoc* Experience.
- The California Experience – Neutral Evaluator.
- Development of the Municipal Protection Commission.

#### D. The Structure For Oversight and Emergency Financing:

- Grants from Federal, State and Regional Governmental bodies.
- Loans from Federal, State and Regional Governmental Bodies.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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- State Intercepts of Tax Revenue.
- Involvement in Local Government Budget Process.
- Required Financial Performance and Targeted Levels of Essential Governmental Services.
- State Legislative Assistance in Tax Revenue and Powers.
- Backup by Moral Obligations of the State.
- Considerations Regarding the Appointment of Authority Members.
- Acceleration of Loans and Obligations if Performance Triggers are violated.
- Dealing with the Press.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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- What Powers are essential for State Oversight and Assistance.
  - Exploration of Transfer of Certain Governmental Services (and related costs) to other Governmental Bodies.
  - Consolidation of Regional Essential Governmental Services.
- E. A State Municipal Refinancing or Restructuring Board (could be pursuant to special legislation) Would Supervise a Distressed Local Government and be able to:
- Require balanced budgets, provide economic discipline and reporting;

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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- Issue debt in state name or separate entity to obtain market credibility and access;
- Have power to negotiate debt restructuring and quasi-judicial jurisdiction;
- Review services or costs that can be transferred to other governmental bodies;
- Have right to intercept tax revenue and ensure payment for essential services and necessary operating costs;
- Have power to authorize Chapter 9 if needed;
- Bridge financing or refinancing of troubled debt;
- Transfer certain services to other governmental agencies to reduce expenditures;

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

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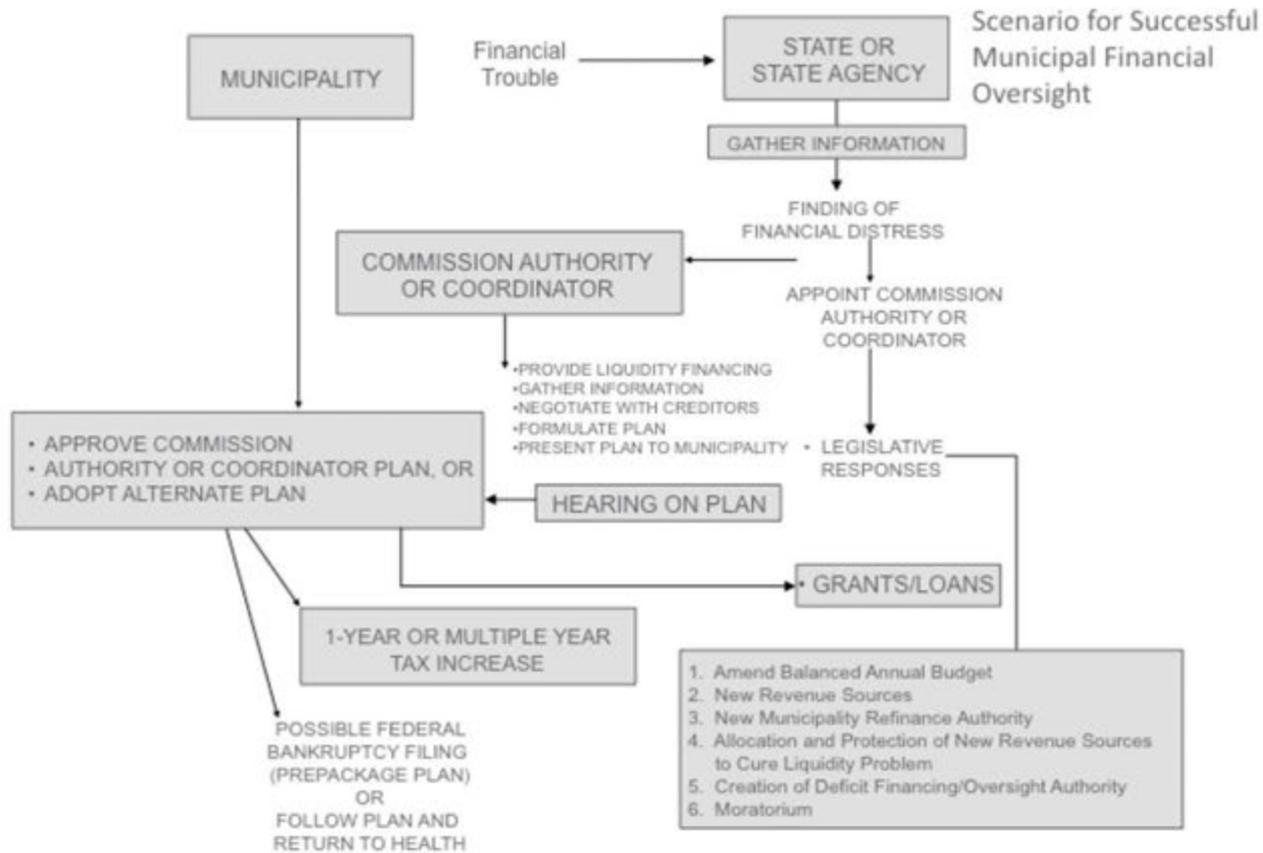
- Grant funds to the municipality to bridge the financial crisis;
- Loan funds to the municipality on terms that are realistic or payable from out-of-state tax sources that can be offset;
- Use intercept of state tax payable to municipality to ensure essential municipal service;
- Private Public Partnerships - Lease and Sale of Municipal Properties to provide bridge financing and cash flow relief;
- Vendor Assistance Program – Providing Vendor Payments through securitization financing of payables. Payment from dedicated tax revenues over time. Provide current cash flow relief from current or future Vendor payments;

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments

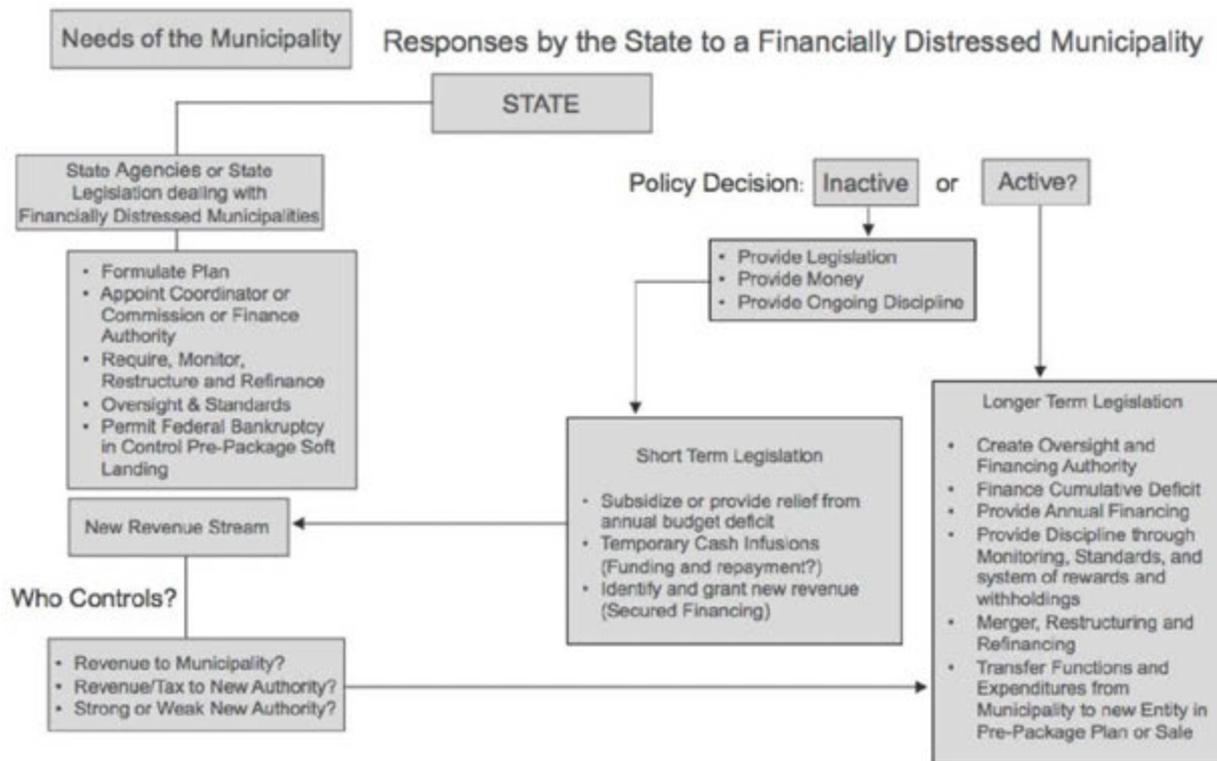
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- Explore Consolidation on a Regional Basis of Certain Governmental Services; and
  - Monitor compliance with any restructuring plan to ensure compliance and prevent financial erosion.
- F. Examples of Structure for Municipal Financial Oversight and State Supervision of Financially Distressed Municipal.

### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments



### III. Debt Resolution Mechanisms: State Oversight, Supervision and Assistance for Emergencies of Local Governments



## IV. Bondholder Rights and Remedies

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- A. The critical differences between Revenue Bonds and General Obligation Bonds, Lease Appropriation Bonds and Conduit Financings:
- Revenue Bonds are generally only payable from the Pledged Revenue, Specific tax source or revenue related to the Municipal enterprise financed and no other recourse to the issuing Municipality.
  - General Obligation Bonds are backed by the full faith and credit of the Municipality and may also have a contractual or statutory pledge of revenue.
  - Upon default Bondholder may institute lawsuits requesting the debt be immediately paid or certain actions be taken by the Municipality or be required to specifically perform under the documents.

## IV. Bondholder Rights and Remedies

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- Municipal Lease or Appropriation Backed Bonds (Non-recourse to municipality's full faith and credit but recourse to annual appropriation or leased property. Note: cannot legally bind successor legislature to appropriate funds).
- Conduit Financing (Non-recourse to municipality, must be for a general public purpose and the credit support is the non-profit or corporate entity benefited).
- Upon default on Lease Appropriation Bonds the remedies are limited to those set forth in the documents and applicable law and generally limited to the municipality's loss of use of the leased facility and ability to relet the facility. In Conduit Financing the remedies are generally limited to the not-for-profit or corporate entity benefitted without recourse to the municipality.

## IV. Bondholder Rights and Remedies

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- B. Upon Default (breach of covenant or failure to make payment of principal or interest), Bondholder may institute a lawsuit for a money judgment, mandamus, specific performance, or equitable relief such as for injunction or an accounting or for foreclosure on collateral (if permitted) or other relief.
- Mandamus – all States would permit a bondholder upon default to petition for mandamus that in essence requires a Municipal official to levy taxes to pay an obligation. The problem is constitutional and statutory debt limits and time, cost and delay.
  - Receiver – 46 States and Puerto Rico permit bondholders to petition a Court to appoint a Receiver upon default especially in the case of a default on the Revenue Bond for financing of a Municipal Enterprise.

## IV. Bondholder Rights and Remedies

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- Accounting – At least 22 States and the District of Columbia and Puerto Rico allow for Bondholders or Representative to bring an action for an accounting to require the local government to account for how bond funds have been spent.
- Foreclosure – At least 28 States permit some form of foreclosure on mortgaged or secured real property upon default on a financing of that facility or structure generally related to conduit financing.
- Injunction – At least 15 States permit bondholder to obtain some form of injunctive relief upon default to protect and preserve their rights and remedies.
- Other Relief.

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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### A. **The Perceived Strength of General Obligation Debt.**

Since the Late 1800’s, no state has defaulted on its General Obligation Debt (except Arkansas in 1933 which debt was promptly refinanced).

1. **What is a G.O.?** A government in issuing General Obligation Debt is perceived by the market as “pledging” its full faith and credit (taxing power) to the payment of that Debt. But the devil is in the details and wording of the authorizing legislation or resolution.
2. **Are There Tax Limits?** Most states have constitutional or statutory debt or tax limitations (see 50 State Survey in “Municipalities in Distress?”). Accordingly, some General Obligation Debt is limited by those restrictions.
3. **Are There No Tax Limits?** Some states provide (generally with required voter approval) “unlimited” General Obligation Debt which has been authorized as not having any limitation on the tax pledge.

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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- 4. Specific Pledges and Statutory Liens.** While General Obligation Debt may have the promise of the government to levy taxes sufficient to pay the obligations (its full faith and credit), there is a distinction between General Obligation Debt that has no specific pledge or dedication of a specific tax source for payment and General Obligation Debt that has a dedication by pledge (security interest) or statutory lien of a specific dedicated source of payment. General Obligation Bonds that have both the “full faith and credit taxing power of the government” and a specific pledge or statutory lien on a specific property or revenue source for payment of the debt are sometimes referred to as “double barrel” bonds.

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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- 5. The Devil is in the Details and the Disclosure.** Specific attention should be paid to whether there is a general statement that the government pledges its full faith and taxing power to pay the General Obligation Debt or whether there is specific language in the authorizing resolution or legislation that dedicates specific property, revenues or tax source for payment of the debt or a specific state statute that creates and grants, by its express provisions governing the issuance of such debt, a lien on property or revenues for the payment of the debt without any further action by the government. Full and accurate disclosure of this is key to understanding whether a G.O. debt has something more.

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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- 6. G.O.s That Are Not G.O.s?** If a state reserves to itself the full power to tax and the municipalities have no power to tax and the state must pass specific legislation authorizing that municipality to be able to levy any tax, can such a municipality in such a state be really recognized as capable of issuing General Obligation Debt? If the municipality cannot levy taxes on its own, and has no power to do so, what is the benefit of a promise to levy a tax if the municipality has no power to levy if the state does not so authorize (see Alabama where only the state can authorize the levy of a new tax)?

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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### B. State Constitution or Law Mandating Priorities, Set Asides, Appropriations and Statutory Liens for General Obligation Debt.

1. **Priorities.** Some states set forth either in their constitution or law that there is a specific priority for the payment of General Obligation Debt for the state or even a municipality’s general obligation bonds (see California — constitutional priority for the state’s G.O. Debt second only to education funding; Hawaii — first charge on state’s general fund; also Louisiana, Missouri, Tennessee, Texas and Wisconsin).

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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- 2. Set Asides.** Some states require a monthly or periodic set aside of revenues to assure payment of General Obligation Debt when it comes due. The Set Aside may be required by state constitution or statute. If there is a failure to follow the mandated Set Aside, the bondholders may choose to enforce the Set Aside of funds by mandamus or other judicial relief. (States with some form of Set Aside are: Illinois — monthly payments of 1/12th of principal coming due in next 12 months and 1/6th of interest coming due in next six months; Vermont from General Funds when debt become due; Minnesota; also Delaware, Georgia, Louisiana, Maine, Michigan, Mississippi, Montana, New York, Pennsylvania, Rhode Island and Virginia — if state fails to timely pay the General Obligation Debt.)

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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3. **Mandated Appropriations.** Some states mandate that the state must appropriate sufficient revenues to pay General Obligation Debt or if the state lacks funds to pay General Obligation Debt when it becomes due the state must then so appropriate sufficient funds. (See **I.** Alaska, Arizona, Arkansas, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Maine, Maryland, Minnesota, Mississippi, Missouri, Nevada, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Tennessee, Utah and Wisconsin — to appropriate sufficient funds to pay debt when due; **II.** Iowa, Kansas and South Dakota — irrepealable tax to pay bond debt; and **III.** New Jersey, South Carolina and Washington — to appropriate if failure to pay general obligations when it comes due.

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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- 4. Statutory Liens.** Some states provide by statute that the state or local government, upon issuing debt pursuant to a specific state statute, automatically has a lien granted on specified property or tax revenue for the payment of the debt so incurred. As discussed in the Municipal Bankruptcy section, this statutory lien remains unaltered in a chapter 9 proceeding and there is a continuing right to be paid after the filing of a chapter 9. This was recognized in the Orange County Chapter 9 in 1994 and Sierra Kings Health Care District Chapter 9 in 2009 (relating to General Obligation Bonds). (There are 32 states with statutory lien provisions. See the 50 State Survey that follows and “Municipalities in Distress?”)

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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- 5. Special Revenue Pledges.** Every state provides for some form of special revenue bonds and, in certain cases, the special revenue pledge can be granted for General Obligation Debt. A special revenue pledge is one that promises to pay the debt from a pledge or dedication of revenues from a specific source or governmental enterprise, special excise taxes, incremental tax receipts for tax incremental financing, revenues derived from a particular governmental function, taxes levied to finance a project or system (except for general sales, property and income taxes levied for general purposes). As noted in the Municipal Bankruptcy section, a Special Revenue Pledge is to be unaltered by a chapter 9 Municipal Bankruptcy and the timely payment of the Pledged Revenues by the municipality is required by the Bankruptcy Code. Both the Sierra Kings Health Care District Chapter 9 (Eastern District of California) and the Jefferson County Chapter 9 (Northern District of Alabama) reaffirmed the unaltered status and timely payment of Special Revenue Pledges in a chapter 9 proceeding.

## V. How to Determine If a General Obligation Bond Is Really a “General Obligation” Bond

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### C. **A 50 State Survey of Priorities, Required Set Asides and Appropriations, Statutory Liens and Special Revenue Pledges for General Obligation Debt.**

1. **The Preliminary Results of a 50 State Survey.** Chapman and Cutler LLP is conducting a 50 State Survey of the Priorities, Required Set Asides and Appropriations for payment of General Obligation Debt, as well as the applicable Statutory Liens and Special Revenue Pledges. This is a preliminary report on the findings and is subject to further review and change as the study is completed. The following is a chart summarizing by state whether there is any provision in that state relating to priorities for payment or mandated set aside of revenues or appropriations of revenues for the payment of General Obligation Debt or whether there is permitted a statutory lien or special revenue pledge.

## VI. Municipal Bankruptcy Chapter 9 Issues

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### A. What is Chapter 9?

- Exclusive chapter of the Bankruptcy Code that provides a method for municipalities to adjust debt:
  - The chapter of the Bankruptcy Code providing for municipal debt adjustment to a level that is affordable (which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts).
  - The first municipal bankruptcy legislation was enacted in 1934 during the Great Depression. Although Congress took care to draft the legislation so as not to interfere with the sovereign powers of the states guaranteed by the Tenth Amendment to the Constitution, the Supreme Court held the 1934 Act unconstitutional as an improper interference with the sovereignty of the states. Congress enacted a revised Municipal Bankruptcy Act in 1937. The law has been amended several times since 1937.

# VI. How Is Municipal Debt Treated in a Chapter 9 Proceeding? (Priority of Payment)

## Summary of Chapter 9 Priorities

<u>TYPE OF CLAIM</u>	<u>EXPLANATION</u>
1. Obligations secured by a statutory lien to the extent of the Pledged Revenue collected. <sup>ab</sup>	Debt (Bonds, Trans, Rans) issued pursuant to statute that itself imposes a pledge. (There may be delay in payments due to automatic stay - unless stay is lifted - but ultimately will be paid.)
2. Obligations secured by Special Revenues (subject to necessary operating expenses of such project or system) to the extent of the Pledged Revenue collected. <sup>ab</sup> These obligations are often non-recourse and, in the event of default, the bondholders have no claim against non-pledged assets.	Special Revenue Bonds secured by any of the following: (A) receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used or intended to be used primarily to provide transportation, utility, or other services, including the proceeds of borrowings to finance the projects or systems; (B) special excise taxes imposed on particular activities or transactions; (C) incremental tax receipts from the benefited area in the case of tax-increment financing; (D) other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions; or (E) taxes specially levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor. <sup>c</sup>  There should be no delay in payment since automatic stay is lifted under Section 922(d).

a Chapter 9 incorporates § 506(c) of the Bankruptcy Code which imposes a surcharge for preserving or disposing of collateral. Since the municipality cannot mortgage city hall or the police headquarters, municipal securities tend to be secured by a pledge of a revenue stream. Hence, it is seldom a surcharge will be imposed. *But see* numbers 3 and 4.

b Chapter 9 incorporates § 364(d) of the Bankruptcy Code, which permits a debtor to obtain post-petition credit secured by a senior or equal lien on property of the estate that is subject to a lien if the prior lien holder is adequately protected.

c A pledge of revenues that is not a Statutory Lien or Special Revenue Pledge may be attached as not being a valid continuing Post-Petition Lien under § 552 of the Bankruptcy Code.

# VI. How Is Municipal Debt Treated in a Chapter 9 Proceeding? (Priority of Payment)

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<u>TYPE OF CLAIM</u>	<u>EXPLANATION</u>
3. Secured Lien based on Bond Resolution or contractual provisions that does not meet test of Statutory Lien or Special Revenues to the extent perfected prepetition, subject to the value of prepetition property or proceeds thereof. <sup>c</sup>	Under language of Sections 522 and 958, liens on such collateral would not continue postpetition. After giving value to the prepetition lien on property or proceeds, there is an unsecured claim to the extent there is recourse to the municipality or Debtor. You may expect the creditor to argue that pursuant to Section 904, the Court cannot interfere with the property or revenues of the Debtor, and that includes the grant of security to such secured creditor.
4. Obligations secured by a municipal facility lease financing.	Under Section 929 of the Bankruptcy Code, even if the transaction is styled as a municipal lease, a financing lease will be treated as long-term debt and secured to the extent of the value of the facility.
5. Administrative Expenses (which would include expenses incurred in connection with the Chapter 9 case itself). <sup>d</sup> Chapter 9 incorporates Section 507(a)(2) which, by its terms, provides a priority for administrative expenses allowed under Section 503(b). These would include the expenses of a committee or indenture trustee making a substantial contribution in a Chapter 9 case.	Pursuant to Section 943, all amounts must be disclosed and be reasonable for a Plan of Adjustment to be confirmed.

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<sup>d</sup> These expenses strictly relate to the costs of the bankruptcy. Because the bankruptcy court cannot interfere with the government and affairs of the municipality, general operating expenses of the municipality are not within the control of the court, are not discharged and will remain liabilities of the municipality after the confirmation of a plan or dismissal of the case .

# VI. How Is Municipal Debt Treated in a Chapter 9 Proceeding? (Priority of Payment)

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<u>TYPE OF CLAIM</u>	<u>EXPLANATION</u>
<p>6. Unsecured Debt includes:</p> <ul style="list-style-type: none"> <li>A. Senior Unsecured Claims with benefit of subordination paid to the extent of available funds (without any obligation to raise taxes) which include any of B, C, D, or E below.</li> <li>B. General Obligation Bonds.</li> <li>C. Trade.</li> <li>D. Obligations for Accrued but Unpaid Prepetition Wages and Pensions and other Employee Benefits.</li> <li>E. Unsecured portion of secured indebtedness.</li> <li>F. Subordinated Unsecured Claims.</li> </ul>	<p>Secured by the “full faith and credit” of the issuing municipality. Postpetition, a court may treat general obligation bonds without a statutory lien or Special Revenues pledge as unsecured debt and order a restructuring of the bonds. Payment on the bonds during the bankruptcy proceeding likely will cease.</p> <p>Vendors, suppliers, contracting parties for goods or services. Payment will likely cease for prepetition goods or services.<sup>e</sup></p> <p>These do not enjoy any priority, unlike in a Chapter 11.<sup>f</sup></p> <p>Any debt subordinated by statute or by contract to other debt would be appropriately subordinated and paid only to the extent senior claims are paid in full. Senior debt would receive <i>pro rata</i> distribution (taking unsecured claim and subordinated claim in aggregate) attributable to subordinated debt until paid.</p>

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<sup>e</sup> Section 503(b)(9) provides for a priority claim to be paid on confirmation of a plan for the value of goods provided prepetition within 20 days of the petition date.

<sup>f</sup> Chapter 9 does not incorporate § 1113 of the Bankruptcy Code, which imposes special provisions for the rejection of collective bargaining agreements (making the standard less restrictive, *i.e.*, “impairs ability to rehabilitate”) or § 507(a)(4) and (5), which give a priority (before payment of unsecured claims) to wages, salaries, commissions, vacation, severance, sick leave or contribution to pension plans of currently \$11,725 per employee.

## VI. Municipal Bankruptcy Chapter 9 Issues

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- Not a tool for elimination of municipal debt:
  - Since a municipal unit is intended to continue to provide governmental services in perpetuity and is not intended to liquidate its assets to satisfy creditors but rather continue to function as a municipality, the primary purpose of Chapter 9 is to allow the municipality to continue operating and keep creditors away while it adjusts or refinances creditor claims.
  - Adjustment of the debts of a municipality is typically accomplished either by extending debt maturities, reducing the amount of principal or interest, or refinancing the debt by obtaining a new loan.
  - More appropriate to refer to Chapter 9 as municipal debt adjustment rather than municipal bankruptcy.
- It is voluntary, a municipality cannot be forced into bankruptcy.

## VI. Municipal Bankruptcy Chapter 9 Issues

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- B. Who is eligible to file Chapter 9 – only those municipalities that are specifically authorized by their State law can file.
- To be a Debtor in a Chapter 9, an entity must be:
    - An entity that is a municipality (political subdivision, public agency or instrumentality of State – States are a co-Sovereign with the Federal Government and cannot file for Chapter 9);
    - Specifically authorized under State law to be a Debtor. Twelve States have Statutory Provisions in which the State specifically authorizes filing (AL, AZ, AR, ID, MN, MO, MT, NE, OK, SC, TX, WA), another twelve States authorize a filing conditioned on a further act of the State, an Elected Official or State entity or neutral evaluator (CA, CT, FL, KY, LA, MI, NJ, NC, NY, OH, PA, RI). Three states (CO, OR and IL) grant limited authorization, two states prohibit filing (GA) but one of them (IA) has an exception to the prohibition. The remaining

## VI. Municipal Bankruptcy Chapter 9 Issues

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21 are either unclear or do not have specific authorization (California, one of the 12 states that conditionally authorized Chapter 9 by municipalities, has new legislation enacted on October 9, 2011, adding the requirement that, before being able to file Chapter 9, a municipality must first either (i) use a neutral evaluator or (ii) declare a fiscal emergency finding there is jeopardy to the health, safety or well being of its residents and it is unable to pay its obligations within the next 60 days);

– Insolvent:

- Proving insolvency can be challenging. As Municipality has to prove it is not paying its debts or is unable to pay its debts when they come due;

## VI. Municipal Bankruptcy Chapter 9 Issues

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- Willing to effectuate a plan; and
- Either have obtained the agreement of creditors holding majority amount of the claim of each class that the municipality intends to impair or have attempted to negotiate in good faith, but was unable to do so or it was impractical to negotiate with creditors or a creditor is attempting to obtain a preference.

# VI. Municipal Bankruptcy Chapter 9 Issues

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The following are statutory provisions in which states have authorized Chapter 9 filings for certain governmental entities

## 12 States that specifically authorize municipal bankruptcies:

Ala. Code 1975 § 11-81-3  
Ariz. Rev. Stat. Ann. § 35-603  
Ark. Code Ann. § 14-74-103  
Idaho Code Ann. § 67-3903  
Minn. Stat. Ann. § 471.831  
Mo. Ann. Stat. § 427.100  
Mont. Code Ann. § 7-7-132  
Neb. Rev. St. § 13-402  
Okla. Stat. Ann. tit. 62 § § 281, 283  
S.C. Code Ann. § 6-1-10  
Tex. Loc. Gov't Code § 140.001  
Wash. Rev. Code § 39.64.040

The 21 Remaining States are either unclear or do not have specific authorization. AK, DE, HI, IN, KS, ME, MD, MA, MS, NE, NH, NM, ND, SD, TN, UT, VA, VT, WV, WI, WY.

## 12 States that *conditionally* authorize municipal bankruptcies:

Cal. Gov't Code § 53760  
Conn. Gen. Stat. Ann. § 7-566  
Fla. Stat. Ann. § 218.01 and § 218.503  
Ky. Rev. Stat Ann. § 66.400  
La. Rev. Stat. Ann. § 39-619  
Mich. Comp. Laws § 141.1222  
N.J. Stat. Ann. § 52:27-40  
N.C. Gen. Stat. Ann. § 23-48  
N.Y. Local Finance Law § 85.80  
Ohio Rev. Code Ann. § 133.36  
53 Pa. Cons. Stat. Ann. § 11701.261  
R.I. Gen. Laws § 45-9-7

## 3 States with limited authorization

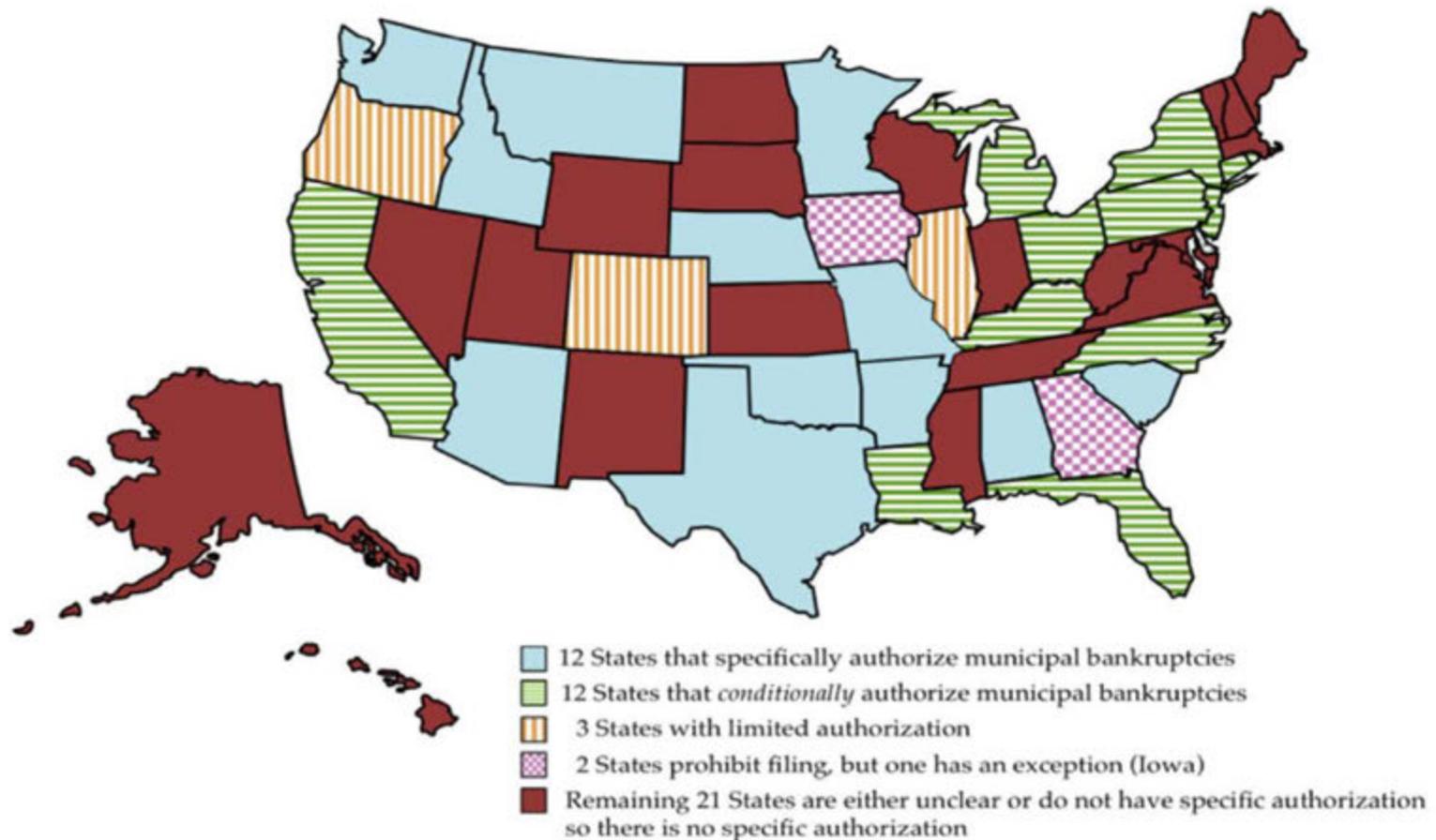
- Colorado has enacted legislation specifically authorizing its beleaguered special taxing districts to file a petition under Chapter 9. Section 32-1-1403 of the Colorado revised statutes states that "any insolvent taxing district is hereby authorized to file a petition authorized by federal bankruptcy law and to take any and all action necessary or proper to carry out the plan filed with said petition..." (CRS § 37-32-102 (Drainage & Irrigation District))
- Oregon permits Irrigation and Drainage Districts to file (Or. Rev. Stat. § 548.705)
- Illinois – specific authorization solely for the Illinois Power Agency (20 Ill Comp. Stat. Ann. 3855/1-20(b)(15)). The Local Government Financing and Supervision Act permits that commission to recommend that the Legislature authorize a filing but it is not specific authorization (20 Ill. Comp. Stat. Ann. 320/9(b)(4))

## 2 States prohibit filing but one has an Exception

- Iowa generally prohibits filing Chapter 9 (Ia. Code Ann. § 76.16) but allows filing for insolvency caused by debt involuntarily incurred not covered by insurance proceeds (Ia. Code Ann. § 76.16A)
- Georgia prohibits the filing of Chapter 9 Bankruptcy (Ga. Code Ann. § 36-80-5)

## VI. General Analysis of State Specific Authorization for Municipalities to File a Chapter 9 Case

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## VI. Municipal Bankruptcy Chapter 9 Issues

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### C. When Has It Been Used?

- To adjust the level of debt obligations of a municipality so the debt is sustainable and affordable:
  - Historically municipalities generally have used Chapter 9 to restructure or adjust legal judgments or obligations to employees (such as pension and health care benefits) and not as a method to eliminate municipal debt.

## VI. Municipal Bankruptcy Chapter 9 Issues

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- To restructure burdensome labor contracts:
  - Due to statutory limitations placed upon the power of the court in a municipal debt adjustment proceeding, the court is not intended to be involved in the municipality's government or affairs or municipal operations while the municipal debtor's pre-petition debt obligations are undergoing adjustment. The municipal debtor as a sub-sovereign of the state has powers to use its property, raise taxes, and make expenditures as it sees fit. It is also permitted to adjust burdensome contractual relationships under the power to reject executory contracts and unexpired leases, subject to bankruptcy court approval, and it has the same avoiding powers as other debtors. Municipalities may also reject collective bargaining agreements and retiree benefit plans without going through the usual procedures required in chapter 11 cases.

## VI. Municipal Bankruptcy Chapter 9 Issues

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- To avoid or restructure legal settlements and judgments.
- Losses on or poor investment strategies.
- To restructure pension and health care related liabilities.
- To restructure contractual obligations.
- To restructure debt on a failed enterprise or proprietary project.
- To restructure tax-exempt debt.

## VI. Municipal Bankruptcy Chapter 9 Issues

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- To be used as a last resort when all other compromise and restructuring efforts fail to reduce debt obligations of municipalities so that essential governmental services can continue to be provided:
  - A municipality has authority to borrow money during a chapter 9 case as an administrative expense. 11 U.S.C. § § 364, 901(a). This ability is important to the survival of a municipality that has exhausted all other resources. A chapter 9 municipality has the same power to obtain credit as it does outside of bankruptcy. The bankruptcy court does not have supervisory authority over the amount of debt the municipality incurs in its operation. The municipality may employ professionals without court approval, and the professional fees incurred are reviewed only within the context of plan confirmation.

## VI. Municipal Bankruptcy Chapter 9 Issues

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- B. The use of dedicated revenue or tax sources (Special Revenues or Statutory Liens) to pay the Bonds and other methods to ensure that willingness to pay is not or should not be a factor.
  - 1. In General Obligation Bonds, the use of additional pledge of dedicated revenue such as unlimited *ad valorem* tax pledge to have the taxing authority mandated to levy taxes sufficient to pay principal and interest on the Bonds and pay the collected funds to the Bond Trustee or paying agent. This could be “Special Revenues” or “Statutory Liens” or both. There would be by covenant and bond resolution or statute that specifically provides the dedication of those revenues or taxes to the payment of the Bonds with provisions that ensure the revenues and taxes cannot be used for any other purposes until the Bonds are paid in full. There are 28 states with Statutory Liens for general obligations/*ad valorem* debt. All states provide for some form of Special Revenue that is intended to be unimpaired by the filing of a Chapter 9.

# VI. Municipal Bankruptcy Chapter 9 Issues

## C. How are Bonds and Notes Treated in Chapter 9?

TYPE OF BONDS/NOTES	BANKRUPTCY EFFECTS
General Obligation Bonds	<p>Post-petition, a court may treat general obligation bonds without a statutory lien as unsecured debt and order a restructuring of the bonds. Payment on the bonds during the bankruptcy proceeding likely will cease.</p> <p>Pre-petition, general obligation bonds are backed by the unlimited taxing power of the municipality (its "full faith and credit") and are historically subject to conditions such as voter authorization, limitations on particular purposes, or debt limitation to a percentage of assessed valuation on the power of municipal entities to incur such debts.</p>
General Obligation Bonds plus Pledged Revenues	<p>Assuming that the general obligation pledge is an actual pledge of revenue and to the extent that it may be classified as a Statutory Lien or Special Revenues, this secured issuance will be respected and unimpaired and paid during a Chapter 9 to the degree it is consistent and authorized under state law. A Pledge of Revenues that is not a Statutory Lien or Special Revenues may be attacked as not being a valid continuing Post-Petition Lien under Section 552 of the Bankruptcy Code. This position may be questioned under Section 904 of the Bankruptcy Code given the prohibition that the Court not interfere with the Government Affairs or Revenues of the Municipality.</p>
Special Revenue Bonds	<p>A pledge on special revenue bonds will survive a bankruptcy filing.</p> <p>Pre-petition, a special revenue bond is an obligation to repay solely and only from revenues of a municipal enterprise (net of necessary operating costs in the case of a gross revenue pledge) that are pledged to bondholders. Special revenues are intended to be unimpaired and to be paid timely during a Chapter 9. The contemplated remedy for default often focuses on a covenant to charge rates sufficient to amortize the debt. Defaulted bondholders are expected to seek mandamus in court to require the municipal borrower to raise its rates.</p>
Revenues subject to Statutory Lien	<p>Assuming the pledge is authorized under state law through a statutory lien, the Bankruptcy Court should respect that statutory lien. Thus, as long as the revenues are subject to a statutory lien, payments to the bondholders should be protected post-petition.</p>

## VII. Chapter 9 – Legal Impact on a Bondholder of Municipal Debt

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- Creditors are subject to automatic stay upon filing of Chapter 9 petition.
- Automatic stay prohibits collection efforts by creditors.
- Automatic stay impacts holders of general obligation bonds or unsecured debt greater than in Chapter 11 because municipalities are afforded great freedom in the use of revenues and assets to perform their governmental functions.
- Bonds or obligations secured by special revenues are exempt from automatic stay (for a statutory lien a lift stay motion may have to be filed) but the tax revenue pledge to pay those bonds is not to be used for any other purpose or otherwise impaired.
- Bonds secured by statutory lien and special revenues are intended to have the lien as pledged tax revenue continue after the filing of a Chapter 9 unlike a corporate pre-petition lien on account receivables or inventory that is terminated as to property created after filing a Chapter 9,

## VII. Chapter 9 – Legal Impact on a Bondholder of Municipal Debt

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- Special Revenue Bonds
- Revenues Subject to Statutory Lien
- A pledge on special revenue bonds will survive a bankruptcy filing.
- Assuming the pledge is authorized and created by state law (statutory lien), the bankruptcy court should respect that statutory lien. Thus, as long as the revenues are subject to a statutory lien, payments to the bondholders should be protected.

## VII. Chapter 9 – Legal Impact on a Bondholder of Municipal Debt

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- General Obligation Bonds
  - Post-petition, a court may treat general obligation bonds without a pledge of a statutory lien or special revenues as unsecured debt and order a restructuring of the bonds. Payment on the bonds during the bankruptcy proceeding likely will cease.
- General Obligation Bonds Plus Pledged Revenues
  - Assuming that the general obligation pledge is an actual pledge of revenue and to the extent that it may be classified as a statutory lien or special revenues, this secured lien on the tax revenues will continue to the extent taxes are collected.
  - A contractual pledge of tax revenue provided for by the bond document that is not a statutory lien or special revenue will have any tax revenue collected before filing paid to the bondholders but after filing that lien is terminated.

## VIII. Chapter 9 (Municipal Debt Adjustment) Is Unlike Chapter 11 (Corporate Reorganization)

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### **IN A CHAPTER 9**

- Only the municipality can initiate a Chapter 9 if authorized by state law.
- Only the municipality can file a Plan of Debt Adjustment.
- The Plan of Debt Adjustment can only adjust debt. It cannot liquidate the municipality.

### **IN A CHAPTER 11**

- The corporation (voluntary) or its creditors (involuntary) can initiate a Chapter 11 case if the corporation is a moneyed entity (not a non-for-profit) and insolvent.
- The corporate debtor (during the exclusive period) or any creditor (after the exclusive period) may file a Plan of Reorganization or Liquidation.
- A corporate plan can be for reorganization or liquidation.

## VIII. Chapter 9 (Municipal Debt Adjustment) Is Unlike Chapter 11 (Corporate Reorganization)

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### IN A CHAPTER 9

- A Labor Agreement can be rejected in a Chapter 9 if the Labor Agreement burdens the municipality and the equities balance in favor of rejection. This is a lower standard than a Chapter 11.
- There is no limitation on damages on real estate leases held by a Trustee or Municipal Building Authority for a lease financing and the lease financing will be treated as a secured debt financing.

### IN A CHAPTER 11

- Section 1113 of the Bankruptcy Code sets forth the requirements for sharing information with employee representatives and workers and the process of information sharing, and the proposal by the debtor prior to the rejection of the Labor Agreement. It is a higher standard than Chapter 9.
- There is a limitation of the greater of one year's rent or 15% of the remaining terms of the lease not to exceed three years for lease damages in a corporate Chapter 11. It is not treated as secured debt of the corporate debtor if it is a true lease.

## VIII. Chapter 9 (Municipal Debt Adjustment) Is Unlike Chapter 11 (Corporate Reorganization)

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### **IN A CHAPTER 9**

- Payments to defease or pay current interest or principal on bonds or notes within the 90 day preference period before a Chapter 9 filing are not capable of being voided or deemed a preference.
- There are no priorities ahead of unsecured claims for prepetition claims due to employee wages, pensions, accrued vacations, healthcare and other employment benefits.

### **IN A CHAPTER 11**

- Payment of principal or interest not secured by collateral could be voided or deemed a preference during the 90 day period prior to filing a Chapter 11 if the holder would receive more than what it would be entitled to in a Chapter 7 liquidation.
- There is a priority ahead of unsecured claims of up to \$11,725 per employee for pre-petition wages, benefits, accrued vacation and healthcare benefits.

## VIII. Chapter 9 (Municipal Debt Adjustment) Is Unlike Chapter 11 (Corporate Reorganization)

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### IN A CHAPTER 9

- “Special Revenues” and “Statutory Liens” are not limited or terminated by a Chapter 9 filing and are intended to continue to be paid to secured creditor and are unimpaired by the Chapter 9 filing (there is no Chapter 11 provisions comparable).
- A Bankruptcy Court cannot interfere with any restrictions or requirements of state law regarding a municipality’s exercise of its governmental powers (including payment of statutory liens). The Bankruptcy Court cannot interfere with the property, revenue and affairs of the municipality.

### IN A CHAPTER 11

- Accounts receivable and inventory created post petition are not covered by the pre-petition lien of a secured lender and the pre-petition lien is terminated except for “proceeds” of the pre-petition lien.
- The corporate debtor cannot take any action outside the ordinary course of business without Bankruptcy Court approval.

## VIII. Chapter 9 (Municipal Debt Adjustment) Is Unlike Chapter 11 (Corporate Reorganization)

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### **IN A CHAPTER 9**

- The municipality can sell its assets, incur debt, borrow money and engage in governmental affairs without the necessity of having to obtain the approval of the Bankruptcy Court.

### **IN A CHAPTER 11**

- The corporate debtor cannot borrow money, sell assets or expand or contract its business without Bankruptcy Court approval.

# IX. Lessons Learned from Recent Distressed Municipalities

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## A. Lessons Learned from the City of Vallejo Case:

- Rejection of Labor Agreement.
- Adverse Effect on Municipal Services.
- Payment of Special Revenue Debt.
- Settlement of Lease Appropriation Bonds.
- Chapter 9 is Very Expensive.
- Chapter 9 is Complicated and Time Consuming.
- Exit of Business Taxpayers During Bankruptcy.
- No Real Increase in Chapter 9 Filings.
- Created the Motivation for a “Neutral Evaluator.”

## B. Lessons Learned from the Central Falls, RI Bankruptcy:

- City’s Attempt to Have a Court Appoint a Receiver was a Shock to the Market.
- Statutory Lien for all Public Debt of Municipalities to Prevent Negative Contagion.
- Expedited Process – Confirmed Plan and Exited Chapter 9 Proceedings in 12 Month – Fastest Chapter 9 for a City, Town and County in Last 10 Years.
- Issues Related to State Pension Funds and Ability to Adjust Municipal Obligations.
- Rhode Island’s First Lien for Bondholders May Create a Trend.

# IX. Lessons Learned from Recent Distressed Municipalities

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## C. Lessons Learned from the City of Harrisburg, PA:

- Financial Problems Should be Addressed Promptly.
- Chapter 9 Filing By Municipalities Need to be Specifically Authorized by the State.
- Finance Only That Which the Municipality Itself Needs.
- In the End if the City Does Not Develop a Feasible Recovery Plan the State Should.
- Raise the Issue of Not Honoring (or Paying) General Obligation Debt and Willingness to Pay.

## D. Lessons Learned from Jefferson County, AL:

- Refinancing Cures All Ills.
- A Municipality Needs the Power to Legislate and Levy Needed Taxes.
- Special Revenues are to be Unimpaired by a Chapter 9 Filing.
- Benefits of Statutory Lien and Special Revenue Status.
- Also Raise Issue of General Obligation Debt and Willingness and Ability to Pay.

# IX. Lessons Learned from Recent Distressed Municipalities

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## E. Lessons Learned from Detroit, MI:

- Major Cities in Distress Need Help from the State.
- Financial Problems of Major Cities Only Get Worse if Not Addressed.
- Labor Costs Must be Sustainable and Affordable and Not Interfere with Providing Essential Governmental Services.
- The Need to Transfer Burdensome Costs of Certain Services to Other Governmental Bodies.
- Local “Buy-In” is Necessary for a Successful Recovery Plan.
- There Must be a Permanent Fix Not a Band Aid.

## F. Lessons Learned from Stockton, San Bernardino and Atwater, CA:

- The Neutral Evaluator has not resulted so far in out of court resolutions.
- Unfunded pension obligations that are not sustainable and affordable need to be addressed and adjusted.
- Priorities of claim (including unfunded pension obligations) should not threaten future ability to borrow or viability of the municipality.
- Impairing public bond debt will have serious consequences.
- The need for an alternative to Chapter 9 that adjusts unsustainable and unaffordable municipal obligations.

## X. Municipalities in Distress?

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Chapman and Cutler LLP has just published a book entitled *Municipalities in Distress?*, which is an analysis of State Laws Dealing with Financial Emergencies of Local Governments (50-State Survey of State Law providing (1) Oversight, Supervision or Assistance to Financially Distressed Municipalities, (2) Rights and Remedies Provided by States to Investors in Financially Distressed Local Government Debt and (3) State Authorization of Municipalities to File Chapter 9 Bankruptcy).

This Survey result may be briefly summarized by the following chart:

# X. Municipalities in Distress?

Analysis of 50 State Survey of Rights and Remedies Provided by States to Investors in Municipal Bond Debt and Authorization to File Chapter 9 Bankruptcy													
(This is an analysis of a 50 State Survey by Chapman and Cutler LLP)													
General Overview of Municipal Insolvency Provisions													
STATE	MUNICIPAL BANKRUPTCY AUTHORIZATION	DEBT LIMITATION	MUNICIPAL RESTRUCTURING MECHANISM	RECEIVER	REFUNDING BONDS	OTHER DEFAULT RESOLUTION REMEDIES	ACCOUNTING	FORECLOSURE	INJUNCTION	MANDAMUS	OTHER REMEDIES	SPECIAL REVENUE BONDS	STATUTORY LIENS
ALABAMA	Y	X		X	X			X	X	X		X	
ALASKA	N				X	X (taxing limits); (appointment of trustee)		X		X		X	X
ARIZONA	Y	X	X (School District Receivership)	X	X			X		X	X (any action necessary)	X	
ARKANSAS	Y	X		X	X	X (taxing limits and appointment of an assessor)				X		X	X
CALIFORNIA	Conditional (Use of a Neutral Evaluator or declaration of fiscal emergency)	X	X (California Debt and Investment Advisory Commission)	X	X	X (negotiations)	X	X	X	X	X (bondholder action and any other action and special tax bonds)	X	X
COLORADO	Limited	X		X	X		X		X	X	X (bondholder action)	X	X
CONNECTICUT	Conditional	X		X	X	X (appointment of a trustee; revenue set aside)			X	X	X (bondholder action/judgment and contractual remedies)	X	X
DELAWARE	N	X			X					X		X	
DISTRICT OF COLUMBIA	N	X	X (District of Columbia Financial Responsibility and Management Assistance Authority)		X		X		X	X	X (declare all bonds due and payable)	X	
FLORIDA	Conditional		X (Bond Financial Emergencies Act and Division of Bond Finance and Local Government Financial Technical Assistance Program)	X	X		X		X	X		X	X
GEORGIA	N (specifically prohibited)	X		X	X	X (debt compromise)				X	X (court action to enforce collection)	X	
HAWAII	N	X		X	X		X	X		X		X	
IDAHO	Y	X	X (debt readjustment plans for certain districts)	X	X	X (Bond Guaranty Act)	X	X		X		X	X
ILLINOIS	Limited	X	X (of financially Distressed City Law and Financial Planning and Supervision)	X	X			X	X	X	X (appropriate relief)	X	X
INDIANA	N	X	X (Distressed Political Subdivision and Township Protections)	X	X	X (redemption bonds)	X	X	X	X		X	X
IOWA	N, with exception	X		X	X	X (moratorium)				X		X	X
KANSAS	N	X		X	X		X	X		X		X	X
KENTUCKY	Conditional	X	X (county restructuring)	X	X	X (taxing limits); (appointment of trustee)	X		X	X		X	X
LOUISIANA	Conditional	X		X	X			X		X		X	X
MAINE	N	X	X (Board of Emergency Municipal Finance)	X	X	X (restructuring)		X		X	X (attachment and any action necessary)	X	X
MARYLAND	N	X		X	X					X		X	X
MASSACHUSETTS	N	X	X (ad hoc state intervention)	X	X	X (state bond payment intervention)				X		X	X
MICHIGAN	Conditional	X	X (Emergency Financial Management and Local Government and School District Fiscal Accountability Act)	X	X					X		X	X
MINNESOTA	Y	X	X (Back-Up Payment Procedures for Municipalities and School Districts)		X	X (back-up payment procedures for municipalities and school districts)				X	X (appropriate remedies to enforce bondholder rights)	X	
MISSISSIPPI	N	X		X	X	X (municipal borrowing)	X	X	X	X	X (other appropriate remedies)	X	X
MISSOURI	Y	X		X	X		X	X		X	X (other appropriate remedies)	X	
MONTANA	Y, but no counties	X		X	X					X	X (limited remedy and interest penalty, suits in equity)	X	
NEBRASKA	Y	X		X	X	X (debt compromise)		X		X		X	
NEVADA	N	X	X (Local government Financial Assistant and Audit Enforcement Act)	X	X	X (third party agreements)	X	X	X	X		X	X

# X. Municipalities in Distress?

STATE	MUNICIPAL BANKRUPTCY AUTHORIZATION	DEBT LIMITATION	MUNICIPAL RESTRUCTURING MECHANISM	RECEIVER	REFUNDING BONDS	OTHER DEFAULT RESOLUTION REMEDIES	ACCOUNTING	FORECLOSURE	INJUNCTION	MANDAMUS	OTHER REMEDIES	SPECIAL REVENUE BONDS	STATUTORY LIENS
NEW HAMPSHIRE	N	X	X (Emergency Financial Assistance)	X	X	X (emergency financial assistance)				X	X (contractual remedies)	X	
NEW JERSEY	Conditional	X	X (Local Government Supervision Act, Municipal Rehabilitation and Economic Recovery Act of 2002 and Special Municipal Aid Act)	X	X		X	X		X		X	X
NEW MEXICO	N	X		X	X					X		X	
NEW YORK	Conditional	X	X (Emergency Financial Control Board, Municipal Assistance Corporation, New York Financial Control Board)	X	X	X (appointment of a trustee)	X	X		X		X	X
NORTH CAROLINA	Conditional	X	X (local government debt monitoring; local government fiscal management)	X	X			X		X		X	X
NORTH DAKOTA	N	X		X	X					X		X	X
OHIO	Conditional	X	X (fiscal watch; fiscal emergencies; and financial planning and supervision commission)	X	X		X	X	X	X	X (general remedies provision, including appointment of trustee and action to declare bonds not paid from property taxes immediately payable)	X	
OKLAHOMA	Y	X		X	X	X (settlement of debt)	X			X		X	
OREGON	Limited	X	X (County Public Safety Emergency and Fiscal Control Board and Municipal Debt Advisory Commission)	X	X	X (Municipal Debt Advisory Commission & refunding bond cram-down)		X		X		X	
PENNSYLVANIA	Conditional	X	X (Financially Distressed Municipalities Act; Intergovernmental Cooperation Act)	X	X	X (appointment of a trustee)	X			X		X	
PUERTO RICO	N	X		X	X	X (fiscus provisions)	X			X		X	
RHODE ISLAND	Conditional	X	X (fiscal overseer; municipal receiver; budget commission)	X	X	X (bond insurance requirements; bond payment guarantee)	X	X		X		X	
SOUTH CAROLINA	Y	X		X	X		X	X		X	X (any appropriate action)	X	X
SOUTH DAKOTA	N	X		X	X					X		X	X
TENNESSEE	N	X		X	X		X			X		X	X
TEXAS	Y	X	X (municipal receivership)	X	X			X		X		X	X
UTAH	N	X		X	X					X	X (contractual remedies)	X	X
VERMONT	N	X		X	X			X		X		X	X
VIRGINIA	N	X		X	X					X	X (any contractual remedy)	X	X
WASHINGTON	Y	X		X	X	X (designation of trustee)		X	X	X		X	X
WEST VIRGINIA	N	X		X	X		X	X	X	X		X	X
WISCONSIN	N	X	X (Deficiency Protection for Public Improvement Bonds)		X	X (deficiency protection)		X		X		X	
WYOMING	N	X		X	X		X	X	X	X		X	
<b>TOTAL*</b>		49		23	47	52	24	23	24	15	52	17	30

\*These numbers include both the District of Columbia and Puerto Rico and totals may differ from other materials that only review the 50 states.

# XI. Scorecard for Other Mechanisms for State to Address Financial Distress of Its Local Governments

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Virtually all States have some statutes providing for:

- Ability to refund. (All states have some provision for Refunding Bonds.)
- Debt limitations (at least 49 states have some form of debt limitation).
- Appointment of receivers (at least 46 states).
- Mandamus or remedies upon default to require payment of debt or levying taxes. (All 50 states have mandamus and at least 28 states have some provision for foreclosure, 21 states provide for a statutory right to such an accounting and at least 22 states have other remedies.)
- Statutory liens or special revenues. (All 50 states have some form of special revenue and at least 32 states have statutory liens.)

## XI. Scorecard for Other Mechanisms for State to Address Financial Distress of Its Local Governments

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Active financial supervision or financial review (over half of the States):

- At least 2 - Debt Advisory Commission.
- At least 8 - Statutes providing for debt compromise or adjustment process and intercepts for payment.
- At least 15 - Active technical assistance, grants, loans, budget review.
- At least 23 - Financial control boards, refinance authorities and active outside supervision and review or other default resolution remedies.

Virtually every state has some form of limitation on taxes or debt or a combination of both.

## XII. Conclusion

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- While Political Risk so far for the Municipal Bond Market has not been a real concern, hard times make hard cases. The best protection against being subject to the unwillingness to pay or Political Risk is to follow the best practice of oversight and assistance by various States and reduce or eliminate the opportunity for there to be any question as to whether a payment is to be made or the need for a Chapter 9 proceeding for municipal debt adjustment to be filed. The state and local governments can provide additional assurance by:
  - (A) not authorizing the use of Chapter 9 bankruptcy,
  - (B) hard wiring payment of the Bonds with Statutory Liens or Special Revenues that are dedicated to be used only to pay that Bond or Note,
  - (C) providing in covenants and statutes that the collection of taxes must be paid to first to Bonds and Notes and sufficient taxes are required to be levied to pay such Bonds and Notes timely,
  - (D) provide by statute or constitution provisions a requirement of a balanced budget with teeth for increase taxes or expense cuts if there are successive deficit budgets,

## XII. Conclusion

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- (E) provide by state statute a first lien on all *ad valorem* taxes and revenues to ensure payment of municipal bonds and notes as Rhode Island has recently enacted,
- (F) provide effective remedies and prompt judicial action to ensure payment of Bonds or Notes,
- (G) provide state supervision and oversight and adult supervision as well as early detection triggers for financial distressed municipalities,
- (H) provide the ability of the state to transfer or combine costly and currently unaffordable services from a distressed municipality to other government entities, and
- (I) provide initial and secondary market disclosure of the ongoing financial status of the municipality and any financial distress as well as whether (A)-(H) above have been provided as protection.

## XII. Conclusion

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- The Survey of 50 States reveals various approaches being taken to provide protection to Bondholders and provides some degree of tax or debt limitations, oversight, supervision, especially for distressed municipalities and protection for investors in debt issues by financially challenged local government. There are only 12 States that generally authorizes the filing of Chapter 9 without further action or approval of the state or a state official, and such filings are so few, only 638 since 1937 and, for the most part, small special tax districts and few municipalities of any size.

## XII. Conclusion

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- One of the key ingredients to the success of state and local governments is their ability:
  - (A) to decide locally what infrastructure, improvements, roads, sewers, bridges, schools, public works and parks should be provided for their constituents,
  - (B) to make that decision on a local basis and
  - (C) to implement that decision because they have access to the capital markets at a low cost.
- This access to the capital markets is a unique attribute of local government in the United States and is one that is admired and desired by sovereigns and subsovereigns throughout the world and has made all the difference.
- Historically, financial distress for state and local government has occurred but rarely has it led to the failure to pay for debt that funded essential governmental services.
- There are current situations that may test the long-term viability of the historical premise. Namely it is hoped that Harrisburg, Jefferson County and Stockton are rare aberrations rather than indicative of a growing trend.
- Time and market discipline will determine whether willingness to pay will be a non-issue as it has in the past.

# Selected Examples of the 50 State Survey

California	
<p><b>Municipal Bankruptcy Authority</b></p>	<p>Any county, city, district, public authority, public agency or other entity, without limitation, that is a “municipality” as defined under the Bankruptcy Code or that qualifies as a debtor under any other federal bankruptcy law applicable to local public entities may file a petition under Chapter 9 of the Bankruptcy Code. Unless an entity is specifically identified above, it is not authorized to file a municipal bankruptcy petition.<sup>i</sup></p> <p>The California governor, however, recently signed into law a provision restricting the ability of California municipalities to file a chapter 9 petition. Under the provision, a municipality, as identified in the previous paragraph, may file a petition only if it meets one of two conditions.</p> <p>The first option is that the municipality participate in a “neutral evaluation process,” otherwise known as mandatory mediation, with interested parties. If the process does not resolve all pending disputes with creditors, the municipality may file a chapter 9 petition. A neutral evaluation process may not last more than 60 days from the date a neutral evaluator is chosen, unless the municipality or a majority of participating interested parties elect to extend the process for up to an additional 30 days. The neutral evaluation process shall not last for more than 90 days following the date the evaluator is selected unless the local public entity and majority of interested parties agree to an extension. Further, the local public entity will be required to pay 50 percent of the costs of the neutral evaluation, and the creditors will be required to pay the balance, unless otherwise agreed to by the parties.</p> <p>The second option is for the municipality to declare a “fiscal emergency” and adopt a resolution at a noticed public hearing that includes findings that the financial state of the local government jeopardizes the health, safety, or well-being of its residents absent bankruptcy protections before filing a petition. The resolution must declare that the municipality is or will be unable to pay its obligations within the next 60 days.<sup>ii</sup></p> <p>Between 1980 and December 31, 2011, 39 entities in California have filed petitions under the municipal bankruptcy provisions of the Bankruptcy Code.</p>
<p><b>Debt Default Prevention</b></p>	<p><b>California Debt and Investment Advisory Commission</b></p> <p>The California Debt and Investment Advisory Commission provides technical assistance on debt issuance and public fund investments to local public agencies and professionals in the public finance field. The commission serves as a clearinghouse for public debt issuance information and to assist state and local agencies with monitoring, issuing and managing debt.</p>

# Selected Examples of the 50 State Survey

California (cont'd)	
<p><b>Debt Default Prevention</b> <i>continued</i></p>	<p>Further, all public debt issuers in California are required to submit information to the commission 30 days before the proposed sale date of the debt. No later than 45 days from the actual date of sale, issuers must submit a report on the final sale to the commission, which includes, but is not limited to, the issuer's name, type of sale, principal amount, type of debt instrument, sources of repayment, purpose of the financing, the issuance's rating and the members of the finance team.<sup>iii</sup></p> <p><b>Debt Limitation</b></p> <p>No county, city, town, township, board of education or school district may incur debt exceeding in any year the income and revenue of that year, without a two-thirds vote. Debt may be incurred for public school purposes by majority vote.</p> <p>The California Code contains further limitations. For instance, for a school district or community college district the total amount of bonds issued for certain purposes as defined in the statute may not exceed 1.25 percent of the taxable property in the school district or community college district, or school facilities improvement district. For a county, the total amount of bonded indebtedness may not at any time exceed 5 percent of the taxable property in the county. If a water conservation, flood control, irrigation, reclamation or drainage works, improvements, or the construction of select county roads is included in a proposition, the total indebtedness may exceed 5 percent but cannot exceed 15 percent of the taxable property of the county.<sup>iv</sup></p> <p><b>Negotiations</b></p> <p>At least one provision of the California Code provides that if a district is in debt, it has no power to impair or destroy any of its indebtedness without bondholder consent. The district may make arrangements with creditors to surrender the indebtedness at less than par and may levy an assessment for bondholder payment.<sup>v</sup></p> <p><b>Refunding Bonds</b></p> <p>The governing body of certain municipal entities may issue refunding bonds to refund outstanding notes.<sup>vi</sup></p>

# Selected Examples of the 50 State Survey

California (cont'd)	
<p><b>Debt Default Prevention</b> <i>continued</i></p>	<p><b>School District Budget Requirements</b> Certain California school districts are required to submit a budget to the county superintendent, which may disapprove the budget in certain situations. Should a disapproval occur, the county superintendent may call for the formation of a budget review committee. The budget review committee will then work with the school district to create an approvable budget. After the appointment of a budget review committee, if the school district still fails to create an allowable budget, the county superintendent may take over certain functions of the school district.<sup>vii</sup></p>
<p><b>Mechanisms for Resolution after Default</b><sup>viii</sup></p>	<p><b>Receivership</b> In certain situations, California law allows for the appointment of a receiver with respect to revenue bonds where a default has occurred.<sup>ix</sup></p>
<p><b>Remedies on Default</b></p>	<p><b>Accounting</b> In certain default situations, bondholders may bring a proceeding in any court of competent jurisdiction to require the authority in question to account as if it were a trustee of an express trust.<sup>x</sup></p> <p><b>Bondholder Action</b> In certain situations, bondholders may bring any appropriate suit on default.<sup>xi</sup></p> <p><b>Foreclosure</b> In certain situations generally involving special revenue bonds, bondholders may foreclose on a project when a default has occurred.<sup>xii</sup></p> <p><b>Injunctive Relief</b> In certain situations, California law authorizes bondholders to bring any action or suit in equity to enjoin any act that may be unlawful or that may violate the rights of bondholders.<sup>xiii</sup></p> <p><b>Mandamus</b> In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection.<sup>xiv</sup></p> <p><b>Any Other Remedies</b> Certain provisions of California law allow for a bond resolution to set forth the rights and remedies of holders of the bonds.<sup>xv</sup></p>

# Selected Examples of the 50 State Survey

California (cont'd)	
<p><b>Other Bondholder Protections</b></p>	<p><b>Special Revenue Bonds</b></p> <p>As provided by § 922(d) of the Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue.<sup>xvi</sup></p> <p><b>Special Tax Bonds</b></p> <p>In certain situations, on approval of two-thirds of eligible voters voting, in the case of community facilities districts, the district may incur bonded indebtedness and establish or change appropriations limits. The proceeds of the bonds issued are pledged and committed to pay or repay the principal and interest on the bonds.<sup>xvii</sup></p> <p><b>Statutory Liens</b></p> <p>Were a municipal entity to file a petition under Chapter 9 of the Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien.<sup>xviii</sup></p>
California Notes	

- i CAL. GOV'T CODE § 53760. California courts have determined that the term “municipality” should not be narrowly construed, although an entity under government control is not necessarily a municipality. *In re County of Orange*, 183 B.R. 595 (Bankr. C.D. Cal. 1995) (finding Orange County Investment Pool not a municipality eligible to file a Chapter 9 proceeding). The court described a “public subdivision” as “any county or parish or any city, town, village, borough, township, or other municipality,” the common thread of which is “their ability to exercise various sovereign powers such as the power to tax, the power of eminent domain or the police power.” *Id.* at 602. Public agencies are “incorporated authorities, commissions, or similar public agencies organized for the purpose of constructing, maintaining and operating revenue producing enterprises.” *Id.* The Bankruptcy Code defines “municipality” as any political subdivision or political agency or instrumentality of a state.
- ii CAL. GOV'T CODE §§ 53760; 53760.1; 53760.3; 53760.5; and 53760.7 (as amended and added by CAL. A.B. 506 (signed into law on October 9, 2011)).

# Selected Examples of the 50 State Survey

## California Notes (cont'd)

- iii CAL. GOV'T CODE § § 8855-8859 (establishing California Debt and Investment Advisory Commission); CAL. GOV'T CODE § 6586.7 (requiring reporting to the commission by issuers under the Marks-Roos Local Bond Pooling Act of 1985); CAL. GOV'T CODE § 53359.5 (reporting requirements).
- iv CAL. CONST. art. XVI, § 18; CAL. EDUC. CODE § 15102 (school district); and CAL. GOV'T CODE § 29909 (counties).
- v See CAL. WAT. CODE § 50901 (reclamation districts).
- vi See, e.g., CAL. GOV'T CODE § § 43720-43747. This provision applies to any city, except a city and a county, if the city has outstanding bonded indebtedness or a judgment against it, or if any department, board or special fund of the city has any outstanding bonds and the bonds were created for a purpose for which the city could have authorized and issued the bonds. The interest on the bonds cannot exceed 8 percent per year. Until the legislative body has sufficient amounts set aside to pay all principal and interest on the bonds as they become due, the legislative body must levy and collect a tax sufficient to make such payments. Another provision allows for local agencies, including any city, county, city and county, or municipal or public corporation or district authorized to acquire, construct, own or operate an enterprise to issue refunding bonds. CAL. GOV'T CODE § § 54660-54662 (Refunding Bonds for Revenue Bond Law of 1941). See also CAL. HARB. AND NAV. CODE § 3917 (Harbor Development Bond Law of 1958).
- vii CAL. EDUC. CODE § § 42122-42129 (Budget Requirements). The county superintendent may: (1) develop and adopt, in consultation with the school district's superintendent and governing board, a fiscal plan allowing the district to meet its financial obligations; (2) cancel purchase orders, prohibit the issuance of nonsalary warrants, and otherwise stay or rescind any action that is inconsistent with the budget adopted; (3) monitor and review the operation of the school district; (4) determine the need for additional staff; (5) require the school district to encumber all contracts and other obligations; (6) determine any financial problem areas; and (7) withhold compensation of the members of the governing board and the district superintendent for failure to provide requested financial information. CAL. EDUC. CODE § 42127.3.
- viii In January, 2011, the Town of Chowchilla, California, defaulted on its January bond payment with respect to bonds issued to renovate its city hall. Chowchilla had in summer 2010, drawn down on its reserves to make an earlier bond payment.
- ix See, e.g., CAL. GOV'T CODE § 15842 (state building construction revenue bonds); CAL. GOV'T CODE § 91537 (industrial development authorities); CAL. WAT. CODE § 36361 (California water districts); and CAL. WAT. CODE § 36364 (California water districts action to secure payment of revenue bonds). The state code may be more expansive, and the statutory authority for each individual bond issuance should be reviewed before assessing whether a receiver may be appointed.

# Selected Examples of the 50 State Survey

## California Notes (cont'd)

- x See, e.g., CAL. GOV'T CODE § 15842 (state building construction revenue bonds); CAL. GOV'T CODE § 54643 (Revenue Bond Law of 1941); and CAL. GOV'T CODE § 67620 (San Francisco Bay Area Transportation Terminal Authority). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether an accounting may be pursued.
- xi See, e.g., CAL. GOV'T CODE § 91537 (industrial development authorities); CAL. GOV'T CODE § 66540.48 (San Francisco Bay Area Water Emergency Transportation Response and Disaster Recovery Act); CAL. EDUC. CODE § 81960 (Community College Revenue Bond Act of 1961); CAL. EDUC. CODE § 90072 (The State University Revenue Bond Act of 1947); CAL. EDUC. CODE § 92491 (The State University Revenue Bond Act of 1947); CAL. GOV'T CODE § 6569 (joint exercise of powers: power to issue revenue bonds); CAL. GOV'T CODE § 15843 (state building construction revenue bonds); CAL. GOV'T CODE § 26370 (revenue bonds for county improvements); CAL. GOV'T CODE § 26470 (revenue bonds for county incinerators); CAL. GOV'T CODE § 50770 (revenue bonds for public improvements); CAL. GOV'T CODE § 54702.8 (cities, counties and other agencies: employee rental housing); CAL. GOV'T CODE § 64118 (California Transportation Financing Authority); CAL. PUB. RES. CODE § 26034 (California Alternative Energy and Advanced Transportation Financing Authority); CAL. PUB. RES. CODE § 32205 (California Urban Waterfront Restoration Financing Authority Act); CAL. PUB. UTIL. CODE § 13106 (Municipal Utility District Act electric system improvements); CAL. PUB. UTIL. CODE § 30981 (Southern California Rapid Transit District); CAL. PUB. UTIL. CODE § 100492 (Santa Clara Valley Transportation Authority); CAL. PUB. UTIL. CODE § 102602 (Sacramento Transit District); CAL. PUB. UTIL. CODE § 103602 (San Mateo County Transit District); CAL. PUB. UTIL. CODE § 105262 (Sonoma-Marín Area RAIL Transit District); CAL. PUB. UTIL. CODE § 120702 (transit development boards); CAL. PUB. UTIL. CODE § 125716 (North County Transit District); CAL. PUB. UTIL. CODE § 132370.10 (transportation consolidation for San Diego); CAL. PUB. UTIL. CODE § 170082 (San Diego County Regional Airport Authority); CAL. STS. & HIGH. CODE § 31171 (El Dorado County Toll Tunnel Authority Act); CAL. STS. & HIGH. CODE § 35417 (Parking District Law of 1951); and CAL. UNCOD. WATER DEER, Act 400 § 33 (Kings River Conservation District Act). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether a bondholder action may be brought.
- xii See, e.g., CAL. GOV'T CODE § 91537 (industrial development authorities). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether bondholders may foreclose on a project.
- xiii See, e.g., CAL. GOV'T CODE § 15842 (state building construction revenue bonds); CAL. GOV'T CODE § 91537 (industrial development authorities); CAL. GOV'T CODE § 6569 (joint exercise of powers: power to issue revenue bonds); CAL. GOV'T CODE § 54644 (Revenue Bond Law of 1941); and CAL. GOV'T CODE § 67620 (San Francisco Bay Area Transportation Terminal Authority). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether injunctive relief may be pursued.

# Selected Examples of the 50 State Survey

## California Notes (cont'd)

- xiv See, e.g., CAL. GOV'T CODE § 15841 (state building construction revenue bonds, allowing bondholders to appoint a trustee to enforce rights of bondholders, including requiring board to collect moneys adequate to carry out the agreement); CAL. GOV'T CODE § 91537 (industrial development authorities); CAL. GOV'T CODE § 66540.48 (San Francisco Bay Area Water Emergency Transportation Response and Disaster Recovery Act); CAL. PUB. UTIL. CODE § 10.1 (West Bay Rapid Transit Authority Act); CAL. EDUC. CODE § 17186 (California School Finance Authority); CAL. EDUC. CODE § 81960 (Community College Revenue Bond Act of 1961); CAL. EDUC. CODE § 90072 (The State University Revenue Bond Act of 1947); CAL. EDUC. CODE § 92491 (The State University Revenue Bond Act of 1947); CAL. EDUC. CODE § 94148 (California Educational Facilities Authority Act); CAL. GOV'T CODE § 6569 (joint exercise of powers: power to issue revenue bonds); CAL. GOV'T CODE § 15444 (Health Facilities Financing Authority Act); CAL. GOV'T CODE § 26370 (revenue bonds for county improvements); CAL. GOV'T CODE § 26470 (Revenue Bonds for County Incinerators); CAL. GOV'T CODE § 50770 (revenue bonds for public improvements); CAL. GOV'T CODE § 54642 (Revenue Bond Law of 1941); CAL. GOV'T CODE § 54702.8 (cities, counties and other agencies: employee rental housing); CAL. GOV'T CODE § 64118 (California Transportation Financing Authority); CAL. GOV'T CODE § 66540.48 (San Francisco Bay Area Water Emergency Transportation Response and Disaster Recovery Act); CAL. GOV'T CODE § 67620 (San Francisco Bay Area Transportation Terminal Authority); CAL. GOV'T CODE § 92308 (California Passenger RAIL Financing Commission Act); CAL. HARB. & NAV. CODE APPX. § 66 (San Diego Unified Port District and Humboldt Bay Harbor, Recreation and Conservation District); CAL. PUB. RES. CODE § 26034 (California Alternative Energy and Advanced Transportation Financing Authority); CAL. PUB. RES. CODE § 32205 (California Urban Waterfront Restoration Financing Authority Act); CAL. PUB. UTIL. CODE § 13106 (Municipal Utility District Act electric system improvements); CAL. PUB. UTIL. CODE § 30981 (Southern California Rapid Transit District); CAL. PUB. UTIL. CODE § 100492 (Santa Clara Valley Transportation Authority); CAL. PUB. UTIL. CODE § 102602 (Sacramento Transit District); CAL. PUB. UTIL. CODE § 103602 (San Mateo County Transit District); CAL. PUB. UTIL. CODE § 105262 (Sonoma-Marin Area Rail Transit District); CAL. PUB. UTIL. CODE § 120702 (transit development boards); CAL. PUB. UTIL. CODE § 125716 (North County Transit District); CAL. PUB. UTIL. CODE § 132370.10 (transportation consolidation for San Diego); CAL. PUB. UTIL. CODE § 170082 (San Diego County Regional Airport Authority); CAL. STS. & HIGH. CODE § 31171 (El Dorado County Toll Tunnel Authority Act); CAL. STS. & HIGH. CODE § 35417 (Parking District Law of 1951); CAL. WAT. CODE § 11708 (conservation, development and utilization of state water resources); CAL. WAT. CODE § 36360 (California water districts, bondholders holding at least 25 percent in outstanding unpaid bonds may bring an action to compel the district to fix and collect sufficient charges to pay the principal and interest on the bonds); and CAL. UNCOD. WATER DEER, Act 400 § 33 (Kings River Conservation District Act). It is possible that an aggrieved bondholder could pursue a writ of mandamus even absent authorizing statutory law.

# Selected Examples of the 50 State Survey

## California Notes (cont'd)

- xv See, e.g., CAL. EDUC. CODE § 90032 (State University Revenue Bond Act) and CAL. EDUC. CODE § 17184 (California School Finance Authority). The state code may be more expansive than the examples cited here, and the statutory authority for each individual bond issuance should be reviewed before assessing whether other remedies may be available to bondholders.
- xvi See, e.g., CAL. GOV'T CODE §§ 6540-6579.5 (joint exercise of powers: power to issue revenue bonds); CAL. GOV'T CODE §§ 54300-54700 (Revenue Bond Law of 1941). These are examples of revenue bonds. The California state code is more expansive and an attorney should be consulted to examine any specific situation involving a default.
- xvii CAL. GOV'T CODE §§ 53345-53365.7.
- xviii For example, see *In re Sierra Kings Health Care District*, Case No. 09-19728 (Bankr. E.D. Cal. September 13, 2010) (confirming the postpetition effectiveness of a municipality's pledge of *ad valorem* taxes which qualifies as both a special revenue pledge and a statutory lien). The bond issuance in *Sierra Kings* was subject to a statutory lien pursuant to CAL. HEALTH & SAFETY CODE § 32300. Also, in 1983 the San Jose School District payment of bonds to bondholders was unaffected by a Chapter 9 filing on July 1, 1983 due to CAL. EDUC. CODE § 15250, which provided a tax pledge to bondholders collected by the county or tax collector to pay bondholders first.

# Selected Examples of the 50 State Survey

Illinois	
<p><b>Municipal Bankruptcy Authority</b></p>	<p>Specific state authority to file a municipal bankruptcy petition only exists with respect to the Illinois Power Agency. With the exception of the Illinois Power Agency, no other municipal entity in Illinois is authorized to file a municipal bankruptcy petition without further legislative authorization.</p> <p>Courts in Illinois have entertained municipal bankruptcy petitions, including <i>In re Village of Brooklyn</i>, Case No. 03-34272 (Bankr. S.D. Ill. Nov. 23, 2004) (confirmation of plan); <i>In re Village of Alorton</i>, Case No. 05-30055 (Bankr. S.D. Ill. Dec. 11, 2006) (confirmation of plan); <i>but see In re Slocum Lake Drainage Dist. of Lake County</i>, 336 B.R. 387 (Bankr. N.D. Ill. 2006) (finding no specific authority and dismissing); <i>In re Washington Park</i>, Case No. 09-31744 (dismissed Dec. 21, 2010, due to lack of authorization). The cases in which plans were confirmed likely were not dismissed because the municipal filings were not challenged.<sup>i</sup></p>
<p><b>Debt Default Prevention</b></p>	<p><b>Debt Limitation</b></p> <p>Various debt issuance provisions in the Illinois Code contain limitations on how much debt a particular municipal entity may issue. For instance, municipalities with less than 500,000 people may issue debt up to 8.625 percent of the total equalized assessed valuation of taxable property in the municipality. A school district for either kindergarten through eighth grade or ninth grade through twelfth grade may only issue bonds up to 6.9 percent of the taxable property in the district. Should a school district contain kindergarten through twelfth grade, the district may issue bonds up to 13.8 percent of the taxable property in the district. Other debt limitations include (a) 2.875 percent of taxable property in counties with populations less than 500,000 and townships, schools or municipal corporations with populations less than 300,000, or park districts, but this 2.875 percent limit does not apply to schools for acquiring or improving a site; constructing, extending, improving and equipping school buildings; or establishing a working cash fund; and (b) 5.75 percent of the value of taxable property for fire protection districts.<sup>ii</sup></p> <p><b>Financially Distressed City Law</b></p> <p>Under this provision, a financially distressed city may receive assistance from the Illinois Finance Authority, which may provide financial aid to the city so that it can provide basic municipal services, while permitting the distressed city to meet its obligations with creditors and bondholders.<sup>iii</sup></p> <p><b>Refunding Bonds</b></p> <p>In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt.<sup>iv</sup></p>

# Selected Examples of the 50 State Survey

Illinois (cont'd)	
<p><b>Mechanisms for Resolution after Default</b></p>	<p><b>Financial Planning and Supervision</b>            Under the <i>Local Government Financial Planning and Supervision Act</i>, a local government with a population less than 25,000 and suffering a “fiscal emergency” in certain instances may upon two-thirds vote of the members of its governing body petition the Governor for the establishment of a financial planning and supervision commission in order to remove the “fiscal emergency.” A unit of local government may contract out of the provisions of the <i>Local Government Financial Planning and Supervision Act</i>.<sup>v</sup></p> <p><b>Receivership</b>            In certain revenue bond default situations, a receiver may be appointed to take possession and operate the project for which the bonds were issued.<sup>vi</sup></p>
<p><b>Remedies on Default</b></p>	<p><b>Appropriate Relief</b>            In certain situations, a bondholder may obtain relief from an “appropriate civil action in the appropriate circuit court.”<sup>vii</sup></p> <p><b>Foreclosure</b>            In certain situations, bondholders may foreclosure on a mortgage and seize and sell the underlying asset.<sup>viii</sup></p> <p><b>Injunctive Relief</b>            In certain situations, bondholders may obtain injunctive relief to enjoin an action with respect to a bond issuance.<sup>ix</sup></p> <p><b>Mandamus</b>            In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection.<sup>x</sup></p>

# Selected Examples of the 50 State Survey

Illinois (cont'd)	
<b>Other Bondholder Protections</b>	<p><b>Special Revenue Bonds</b></p> <p>As provided by § 922(d) of the Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue.<sup>xi</sup></p> <p><b>Statutory Liens</b></p> <p>Were a municipal entity to file a petition under Chapter 9 of the Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien.<sup>xii</sup></p>
Illinois Notes	

- i 20 ILL. COMP. STAT. 3855/1-20(b)(15) (specific authorization for Illinois Power Agency). Pursuant to Illinois law, further, under the *Local Government Financial Planning and Supervision Act*, the financial planning and supervision commission has the power to recommend that the local government file a petition under Chapter 9 and to submit this recommendation to the state legislature. 50 ILL. COMP. STAT. 320/9(b)(4). The Illinois Code, however, does not include any provisions specifically authorizing a public entity, with the exception of the Illinois Power Agency, to file a petition.
- ii 65 ILL. COMP. STAT. 5/8-5-1 (municipalities less than 500,000). Certain exceptions to this provision exist, such as debt incurred for constructing a wastewater facility to comply with the Clean Water Act. This provision, further, does not apply to home rule municipalities. 105 ILL. COMP. STAT. 5/19-1 (school district for either kindergarten through eighth grade or ninth grade through twelfth grade); 105 ILL. COMP. STAT. 5/19-1 (School district containing grades kindergarten through twelfth grade); 50 ILL. COMP. STAT. 405/1 (local governments including counties with populations less than 500,000 and townships, schools or municipal corporations with populations less than 300,000); 50 ILL. COMP. STAT. 405/1.2 (providing exception for working cash fund); 70 ILL. COMP. STAT. 705/12 (fire protection districts); and 70 ILL. COMP. STAT. 1205/6-2 (park districts). These provisions have been provided as examples of statutory debt limitations under the Illinois Code. The state code may be more expansive and an attorney should be consulted to examine any specific situation.

# Selected Examples of the 50 State Survey

## Illinois Notes (cont'd)

- iii 65 ILL. COMP. STAT. 5/8-12-1 *et seq.* “Financially distressed City” means any municipality which is a home rule unit and which (i) is certified by the Department of Revenue as being in the highest 5 percent of all home rule municipalities in terms of the aggregate of the rate per cent of all taxes levied pursuant to statute or ordinance upon all taxable property of the municipality and as being in the lowest 5 percent of all home rule municipalities in terms of per capita tax yield, and (ii) is designated by joint resolution of the General Assembly as a financially distressed city. 65 ILL. COMP. STAT. 5/8-12-3.  
A designation as “financially distressed city” shall last for 10 years until the city submits a balanced budget and proves its responsibility.
- iv *See, e.g.*, 65 ILL. COMP. STAT. 5/8-4-14 (allowing for refunding revenue bonds issued by municipalities with a population less than 500,000) and 65 ILL. COMP. STAT. 1/11-130-12 (allowing for water supply and sewerage system refunding bonds). The state code may be more expansive and the statutory authority for each bond issuance should be reviewed with respect to each proposed refunding bond issuance.
- v 50 ILL. COMP. STAT. 320/1 *et seq.* “Local governments” include counties, cities, villages, incorporated towns, townships, special districts and units of local government that exercise limited governmental powers, but not including school districts. “Fiscal emergency” includes the existence of any one or more of the following conditions: (1) the existence of a continuing default in the payment of principal and interest on any debt obligation for more than 180 days; (2) the failure to make payment of over 20 percent of all payroll to employees of the unit of local government in the amounts and at the times required by law where the failure has continued for more than 30 days after such time for payment, unless two-thirds of such employees agree in writing to such extension; (3) the insolvency of the unit of local government, being a financial condition that the unit is (A) generally not paying its debt as it becomes due unless they are the subject of a bona fide dispute or (B) unable to pay its debts as they become due. 50 ILL. COMP. STAT. 320/3.  
In 1980 the Chicago Board of Education was placed under supervision of the state, and in 1989 East St Louis was placed under state supervision.
- vi *See, e.g.*, 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 455/6 (Medical Services Facilities Revenue Act); 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act); 65 ILL. COMP. STAT. 5/11-103-15 (airports for municipalities of less than 500,000); 65 ILL. COMP. STAT. 5/11-119.1-6 (Joint Municipal Electric Power Agencies’ bond documents may contain provisions allowing for appointment of receiver); 65 ILL. COMP. STAT. 5/11-119.2-6 (Joint Municipal Natural Gas Agencies’ bond documents may contain provisions allowing for appointment of receiver); and 65 ILL. COMP. STAT. 5/11-130-7 and 5/11-130-12 (water supply and sewerage system bonds). The state code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether a receiver may be appointed.

# Selected Examples of the 50 State Survey

## Illinois Notes (cont'd)

- vii *See, e.g.*, 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act) and 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act). The state code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether such a remedy is applicable.
- viii *See, e.g.*, 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 455/6 (Medical Service Facility Revenue Bond Act); and 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act). The state code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether bondholders may pursue a foreclosure action.
- ix *See, e.g.*, 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing the availability of injunctive relief under the particular statute.
- x *See, e.g.*, 70 ILL. COMP. STAT. 200/2-51 (Civic Center Code); 65 ILL. COMP. STAT. 5/11-48.3-11 (municipal zoo authorities); 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 455/6 (Medical Service Facility Revenue Bond Act); 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act); and 65 ILL. COMP. STAT. 5/11-103-15 (airports for municipalities of less than 500,000). It is possible that an aggrieved bondholder could pursue a writ of mandamus even absent authorizing statutory law.
- xi *See, e.g.*, 65 ILL. COMP. STAT. 5/8.4.1-11 (revenue bonds issued by municipalities paid by revenues from operation of utility system or revenue-producing enterprise) and 65 ILL. COMP. STAT. 5/11-130-7 (water supply and sewage system bonds). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
- xii *See, e.g.*, 105 ILL. COMP. STAT. 5/1E-110 (creating statutory lien for Downstate School Finance Authority); 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act, providing that a mortgage or deed of trust attaches without filing); 30 ILL. COMP. STAT. 350/13 (certain qualified governmental units under the Local Government Debt Reform Act) and 65 ILL. COMP. STAT. 5/11-103-15 (airports for municipalities of less than 500,000, establishing statutory mortgage lien). These are examples of statutory liens. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.

# Selected Examples of the 50 State Survey

Michigan	
<p><b>Municipal Bankruptcy Authority</b></p>	<p>Under Michigan law, a local government or school district may file a petition under Chapter 9 of the Bankruptcy Code if an emergency manager who has been appointed by the governor believes the local government has no other alternative and makes a recommendation to the governor and treasurer that the local government or school district should be authorized to file a Chapter 9 petition. In the recommendation, the emergency manager must include either, a determination that no feasible financial plan can be adopted that can satisfactorily rectify the financial emergency of the local government in a timely fashion; or a determination that the emergency manager's plan has been in place for at least 180 days, but cannot be implemented as written or as it might be amended in a manner that can satisfactorily rectify the financial emergency in a timely manner. If the local government is a school district, the emergency manager must also give written notice to the superintendent of public instruction. If the governor approves the emergency manager's recommendation, he or she must notify the emergency manager and treasurer in writing. Unless an entity is specifically authorized, it may not file a municipal bankruptcy petition.</p> <p>Between 1980 and December 31, 2011, two municipal entities in Michigan have filed petitions under Chapter 9 of the Bankruptcy Code — a hospital in 1992 and the Village of Merrill in 1987.<sup>i</sup></p>
<p><b>Debt Default Prevention</b></p>	<p><b>Annual Audit Reporting</b></p> <p>Each municipality must file an annual audit report. The report must meet certain criteria for the municipality to issue municipal securities without further approval of the state. If the municipality does not meet the requirements to issue bonds without state supervision, it must obtain, for each municipal security, the prior written approval of the state.<sup>ii</sup></p> <p><b>Debt Limitation</b></p> <p>The Michigan Constitution contains debt limits for cities, villages and counties. A county may not issue debt totaling more than 10 percent of its assessed valuation. The Michigan legislature may limit debt issued by cities and villages.<sup>iii</sup></p>

# Selected Examples of the 50 State Survey

Michigan (cont'd)	
<p><b>Debt Default Prevention</b> <i>continued</i></p>	<p><b>Local Government and School District Fiscal Accountability Act</b></p> <p>Should a local government request assistance or the treasurer inform the governor that he or she has conducted a preliminary review of a local government financial situation and has determined that certain conditions indicating a serious financial problem exist, the governor must appoint a review team to undertake a local financial management review. The local government may work with the state to develop a plan for resolving the stress and enter into a consent agreement. The consent agreement may include a continuing operations agreement developed by the local government or a recovery plan developed and imposed by the state. Unless the state determines otherwise, the local government is exempt from collective bargaining requirements.<sup>iv</sup></p> <p><b>Refunding Bonds</b></p> <p>In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt.<sup>v</sup></p>
<p><b>Mechanisms for Resolution after Default</b></p>	<p><b>Emergency Financial Management</b></p> <p>If a municipality fails to pay an installment of principal and interest on an outstanding municipal bond on or before its due date, the state treasurer or superintendent for public instruction can investigate the municipality's fiscal affairs, consult with the governing body of the municipality and negotiate with the municipality's creditors to develop a plan for financing, adjusting or compromising the outstanding, overdue bond.<sup>vi</sup></p> <p><b>Municipal Receivership</b></p> <p>If a local government is in such deep financial distress that it is in a financial emergency and a consent agreement under the Local Government and School District Fiscal Accountability Act cannot be reached or is breached, the governor may place the local government into receivership and appoint an emergency manager. The emergency manager has broad powers to operate and restructure the municipality. If an emergency manager is appointed, the chief officer of the municipality's powers are suspended; the emergency manager is granted the ability to modify, terminate or renegotiate contracts, including collective bargaining agreements; the municipality is exempt from collective bargaining requirements for the earlier of five years or the end of the receivership; and the emergency manager may enter into agreements to consolidate services with other local governments and may file a municipal bankruptcy petition on behalf of the municipality.<sup>vii</sup></p>

# Selected Examples of the 50 State Survey

Michigan (cont'd)	
<b>Mechanisms for Resolution after Default</b> <i>continued</i>	<b>Receivership</b> In certain default situations, Michigan law allows for the appointment of a receiver with respect to revenue bonds. <sup>viii</sup>
<b>Remedies on Default</b>	<b>Mandamus</b> In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection. <sup>ix</sup>
<b>Other Bondholder Protections</b>	<b>Special Revenue Bonds</b> As provided by § 922(d) of the Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue. <sup>x</sup> <b>Statutory Liens</b> Were a municipal entity to file a petition under Chapter 9 of the Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien. <sup>xi</sup> Further, on February 7, 2012, the Michigan Governor signed into law a provision establishing a statutory lien on particular aid payments made by the state to certain financially troubled school districts that use those payments to secure bond issuances. <sup>xii</sup>
Michigan Notes	

i MICH. COMP. LAWS § 141.1523 (2011). In November, 2010, Michigan rejected a request for permission to file a municipal bankruptcy petition filed by the municipality of Hamtramck.

# Selected Examples of the 50 State Survey

## Michigan Notes (cont'd)

- ii MICH. COMP. LAWS § 141.2303 (2011). To qualify to issue municipal securities without further approval of the state, the municipality must (a) not be operating under the provisions of the Local Government and School District Financial Accountability Act; (b) have not issued securities in the immediately preceding 5 fiscal years or current fiscal year that were authorized under the Emergency Municipal Loan Act, other than certain loans authorized under that act; (c) have not been required by the terms of a court order or judgment to levy a tax in the previous fiscal year, unless it is determined that the court order did not have an adverse impact on the municipality; (d) have filed its audit report within 6 months from the end of its fiscal year; (e) have certified the debt retirement fund balance for any municipal security that is funded from an unlimited tax levy does not exceed 150 percent of the amount required for principal and interest payments due for the security in the next fiscal year; (f) not be exceeding its statutory or constitutional debt limits; (g) have no outstanding security not authorized by statute; (h) not be in violation of any provisions in the covenants for an outstanding security; (i) not have been delinquent more than one time in the preceding year in transferring employment taxes or pension, retirement or benefit plan contributions; (j) certify that its delinquent property taxes do not exceed 18 percent of the amount levied; (k) not have submitted a qualifying statement or application for any other municipal securities that was materially false or incorrect; (l) certify that it is not in default on the payment of any debt, with the exception of industrial development revenue bonds; (m) not have ended the immediately preceding fiscal year with a deficit in any fund, unless it has a plan to correct the deficit condition; (n) not have been found by a court to be in violation of any finance or tax-related state or federal statutes; (o) not have been in violation of its audit reporting requirements; and (p) have not issued a refunding security in the preceding fiscal year to avoid a potential default on an outstanding security.  
If the state does not grant the municipality a “qualified status” based on its audit, the municipality must obtain, for each municipal security, the prior written approval of the state to issue a municipal security.
- iii MICH. CONST. art. VII, § 11 (counties); MICH. CONST. art. VII, § 21 (cities and villages). Pursuant to MICH. COMP. LAWS § 78.26, a village governed by the Home Rule Village Act may not incur indebtedness exceeding 10 percent of the assessed valuation of the real and personal property within the village subject to taxation.

# Selected Examples of the 50 State Survey

## Michigan Notes (cont'd)

- iv MICH. COMP. LAWS § § 141.1501 to 141.1514(a) (2011). As to whether a municipality is in severe financial stress, there are a number of triggering events, including a written request by the governing body or chief administrative officer, or a major creditor with an undisputed claim remaining unpaid for at least six months and exceeding \$10,000 or 1 percent of the annual general fund budget of the local government; petition of 5 percent of voters voting in the last gubernatorial election; failure to timely deposit its minimum obligation payment to the local government pension fund; notification either that employees have not been paid or that payment is seven or more days late; notice of a bond payment default or violation of a bond covenant; resolution from the state senate or house of representatives; a violation of the municipal finance act, the emergency municipal loan act, or the uniform budgeting and accounting act; failure to provide an adequate annual financial report or audit to the state treasurer; failure to distribute tax revenue, as required by law that has been collected for another taxing jurisdiction; a breach of obligations under a deficit elimination plan or agreement entered into pursuant to a deficit elimination plan; a court order of an additional tax levy without prior approval of the governing body; the municipal government has ended its fiscal year in a deficit; a school district ended its most recently completed fiscal year with a deficit in one or more funds and the district had not submitted a deficit elimination plan to the state financial authority within 30 days after the deadline to submit its annual financial statement; a local government has been assigned a long-term debt rating within or below the BBB category or its equivalent; or under the sole discretion of the state treasurer or the superintendent of public instruction, other facts and circumstances exist indicative of financial stress. MICH. COMP. LAWS § 141.1512 (2011).
- v See, e.g. MICH. COMP. LAWS § 141.2603(1) (allowing any outstanding security that has been assumed in part by another municipality to be refunded by the municipalities as to their respective liabilities) and MICH. COMP. LAWS § 141.2609 (allowing refunding securities under the Drain Code of 1956). Municipalities may issue refunding bonds to refund all or any portion of funded indebtedness, but their issuance must be necessary such as to avoid a default. MICH. CIVIL JUR., *Municipal and Public Bonds* § 51 (2010).
- vi MICH. COMP. LAWS § 141.2802. This provision applies to any county, township, city, village, school district, intermediate school district, community college district, metropolitan district, port district, drainage district or district library or another government authority or agency that has the power to issue a security. MICH. COMP. LAWS § 141.2802. The plan to be established under the provision must be found to be fair and equitable and reasonably within the ability of the municipality to meet. Once the plan is deemed fair and equitable, the department must advise the governing body to take necessary steps to implement the plan. If the governing body does not do so, the department may implement the plan on behalf of the municipality.

# Selected Examples of the 50 State Survey

## Michigan Notes (cont'd)

- vii MICH. COMP. LAWS § § 141.1515 to 141.1531 (2011). An emergency manager may initiate court proceedings in Ingham County, the county in which the Michigan state capital city is located, in the name of the local government to enforce compliance with any emergency manager order or any constitutional or legislative mandate, or to restrain violations of any constitutional or legislative power of his or her orders.
- Under a similar previous law in Michigan, the state had taken over certain municipalities suffering severe financial emergencies. In *Flint City Council v. State of Michigan*, 655 N.W.2d 604 (Mich. Ct. App. 2002), the state treasurer reported to the governor that the City of Flint had a serious financial problem. The governor appointed a financial review team to assess Flint's financial situation and found a substantial general fund deficit. The review team also determined that Flint city officials demonstrated an inability "to accurately monitor revenue and expenditures throughout a given fiscal years and to amend city budgets accordingly." As such, the review team recommended that the governor appoint an emergency financial manager. The city appealed and the court found the governor's decision was supported.
- The state has taken over the Detroit Public Schools; City of Pontiac; City of Escorse; Village of Three Oaks; City of Hamtramck; City of Highland Park; and City of Flint. See Eric Scorsone, *Local Government Financial Emergencies and Municipal Bankruptcy*, Michigan Senate Fiscal Agency Issue Paper, available at <http://www.senate.michigan.gov/sfa/publications/issues/localgovfin/localgovfin.pdf> (last visited July 14, 2011).
- Most recently, on November 29, 2011, the state placed the City of Flint under the control of an emergency manager. Also currently operating under emergency managers appointed by the state are the City of Benton Harbor, City of Ecorse, and the City of Pontiac, and the Detroit Public Schools. See *Governor Names Flint Native as City's Emergency Financial Manager*, Detroit Free Press (Nov. 30, 2011), available at <http://www.freep.com/article/20111130/NEWS06/111300370/Governor-names-Flint-native-city-s-emergency-financial-manager>.
- viii See, e.g., MICH. COMP. LAWS § 141.110 (allowing for appointment of receiver with respect to revenue bonds). Under § 141.110, a receiver may be appointed to administer and operate any public improvement as long as its revenues are pledged to pay the principal and interest on the bonds at issue. The receiver may fix and charge rates and collect revenues sufficient for the payment of any bonds or obligations outstanding, but must act under the direction of the court.
- For instance, in *Farmington Township v. Warrenville State Bank*, 185 F.2d 260 (6th Cir. 1950), bondholders asked the court to appoint a receiver. The court appointed a receiver and found that the receiver was allowed to continue to charge a specified amount each year for water hydrant rentals to help the township repay its debt.

# Selected Examples of the 50 State Survey

## Michigan Notes (cont'd)

- ix *See, e.g.*, MICH. COMP. LAWS § 41.347 (provides that bondholders representing in aggregate not less than 20 percent of entire outstanding bond issue by township water supply and sewage disposal services and facilities may protect and enforce the statutory lien and compel performance of duties by officials of borrower); and MICH. COMP. LAWS § 331.8e(2) (provides that bondholders representing in aggregate not less than 20 percent of entire outstanding bond issue by hospital authority may protect and enforce the statutory lien and compel performance of duties by officials of borrower, including fixing sufficient rates to pay bonds). It is possible that an aggrieved bondholder could pursue a writ of mandamus even absent authorizing statutory law.
- x *See, e.g.*, MICH. COMP. LAWS § 41.343 (revenue bonds for water supply and sewage disposal projects); MICH. COMP. LAWS § § 125.667(5) and 125.709(2) (revenue bonds for housing facilities); and MICH. COMP. LAWS § § 141.107(4) (Revenue Bond Act). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
- xi *See, e.g.*, MICH. COMP. LAWS § 41.346 (establishing statutory lien on net revenues of water supply and sewage disposal project); MICH. COMP. LAWS § § 125.667(5) and 125.709(2) (statutory liens for bonds issued by housing facilities); MICH. COMP. LAWS § 125.1666(2) (Downtown Development Authority bonds providing for statutory lien on tax increment revenues); MICH. COMP. LAWS § 141.108 (establishing statutory lien on net revenues under Revenue Bond Act); MICH. COMP. LAWS § 331.8e (establishing statutory lien on all net revenues on bonds issued by hospital authorities); and MICH. COMP. LAWS § 333.26220a(5) (disposal site revenues subject to statutory lien under Low-Level Radioactive Waste Authority). These are examples of statutory liens. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
- xii 2012 MICH. PUB. ACTS 2 (signed into law Feb. 7, 2012). Under the provision, among other things, if an emergency manager has been appointed pursuant to the Local Government and School District Fiscal Accountability Act, or the district has approved a deficit elimination plan, the portion of state school aid paid or to be paid on behalf of the district to the Michigan finance authority, or to a trustee designated by the authority, for the sole purpose of paying the principal of and interest on a bond, is subject to a statutory lien, paramount to all other liens, for the sole purpose of paying principal and interest on the obligation.

# Selected Examples of the 50 State Survey

Pennsylvania	
<p><b>Municipal Bankruptcy Authority</b></p>	<p>Any municipality, parking authority, public transportation authority, political subdivision, city of the first class or city of the second class may file if meeting one of the following conditions: recommendation of designated plan coordinator; interruption in ability to provide health and safety services; creditor rejection of plan of adjustment; municipal distress solvable via Chapter 9; or failure to follow or adopt recommendations of a designated plan coordinator. “City of the First Class” includes Philadelphia and “City of the Second Class” includes Pittsburgh. Parking authorities in Philadelphia and metropolitan transportation authorities may not file if they have outstanding bonds. Unless a municipality is specifically identified, it is not authorized to file a petition.</p> <p>In addition, on August 1, 2011, the Pennsylvania governor signed into law a provision that would prevent any “City of the Third Class” that has been identified as “financially distressed” under the Municipalities Financial Recovery Act, which includes Harrisburg, Pennsylvania, from filing a petition under Chapter 9 of the Bankruptcy Code. The provision expires on July 1, 2012. Should a city file a petition, all state funding to that city would be suspended. Despite this prohibition, on October 11, 2011, the City of Harrisburg filed such a petition, which subsequently has been dismissed by the court.</p> <p>Between 1980 and December 31, 2011, five municipal entities in Pennsylvania have filed municipal bankruptcy petitions.<sup>i</sup></p>
<p><b>Debt Default Prevention</b></p>	<p><b>Debt Limitation</b></p> <p>The General Assembly has the authority to prescribe debt limits. Philadelphia’s debt may not exceed 13-1/2 percent of the average annual assessed value of taxable property therein, during the 10 years immediately preceding the year of the increase.<sup>ii</sup></p> <p><b>Rehabilitation of Distressed Municipalities</b></p> <p><i>Financially Distressed Municipalities Act.</i> If the State Department of Community Affairs determines a municipality is financially distressed, the department may appoint a coordinator to help the municipality prepare a plan to put its finances in order. The coordinator may hold public meetings and negotiate with creditors and other parties in preparing the plan. If the creditors reject the plan, a triggering event occurs, allowing the municipality to file a municipality bankruptcy petition.<sup>iii</sup></p>

# Selected Examples of the 50 State Survey

Pennsylvania (cont'd)	
<p><b>Debt Default Prevention</b> <i>continued</i></p>	<p><b>Philadelphia Rehabilitation and Oversight</b> <i>Intergovernmental Cooperation Authority Act.</i> This act was created to enable capital market access by cities of the first class (Philadelphia) for deficit elimination and seasonal borrowings to avoid default on existing obligations and chronic cash shortages. The authority may issue bonds and other obligations, but only at the request of the city being assisted. Further, the city assisted and the authority must develop, implement and periodically revise a five-year recovery financial plan. The authority also has the power over the city budget.<sup>iv</sup></p> <p><b>Refunding Bonds</b> In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt.<sup>v</sup></p>
<p><b>Mechanisms for Resolution after Default</b></p>	<p><b>Receivership</b> In certain default situations, Pennsylvania law allows for the appointment of a receiver with respect to revenue bonds.<sup>vi</sup></p> <p><b>Trustee Appointment</b> If a local unit of government defaults on the payment of principal or interest on a bond issuance and the default continues for 30 days, or if the local government unit fails to comply with any provision in a bond or note; or if allowed by the authorizing resolution, and holders of 25 percent in aggregate principal amount of bonds outstanding so choose, a trustee may be appointed to represent bondholders.<sup>vii</sup></p>
<p><b>Remedies on Default</b></p>	<p><b>Accounting</b> In certain default situations, bondholders may bring a proceeding to require the authority in question to account as if it were a trustee of an express trust.<sup>viii</sup></p> <p><b>Mandamus</b> In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection.<sup>ix</sup></p>

# Selected Examples of the 50 State Survey

Pennsylvania (cont'd)	
<p><b>Other Bondholder Protections</b></p>	<p><b>Special Revenue Bonds</b></p> <p>As provided by § 922(d) of the Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue.<sup>x</sup></p> <p><b>Statutory Liens</b></p> <p>Were a municipal entity to file a petition under Chapter 9 of the Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien.</p>
<p><b>Pennsylvania Notes</b></p>	

- i 53 PA. STAT. ANN. §§ 5510.11, 5571, 11701.261, 12720.211, 28211; 74 PA. CONS. STAT. ANN. § 1773. Pursuant to § 5510.11, a parking authority in a city of the first class is not authorized to file a federal bankruptcy petition if such authority has outstanding any bonds issued pursuant to the chapter. Pursuant to § 5571, a political subdivision may file a federal bankruptcy petition only after its petition has been submitted to and approved by the State Department of Internal Affairs. Pursuant to § 11701.261, a municipality, following a vote by a majority of the municipality's governing body, may file a petition pursuant to the federal bankruptcy laws if one of the following conditions is present: (i) after recommendation by the plan coordinator pursuant to § 241(6) of the statute; (ii) imminent jeopardy of an action by a creditor, claimant or supplier of goods or services which is likely to substantially interrupt or restrict the continued ability of the municipality to provide health or safety services to its clients; (iii) one or more creditors of the municipality have rejected the proposed or adopted plan, and efforts to negotiate a resolution of their claims have been unsuccessful for a 10 day period; (iv) a condition substantially affecting the municipality's financial distress is potentially solvable only by utilizing a remedy exclusively available to the municipality through the Federal Municipal Debt Readjustment Act; or (v) a majority of members of the current or immediately preceding governing body of a municipality determined to be financially distressed has failed to adopt a plan or to carry out the recommendations of the coordinator pursuant to the statute. Pursuant to § 12720.211, a city of the first class is not authorized to file a federal bankruptcy petition unless (a) it has no outstanding bonds issued pursuant to the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class and (b) it has received approval from the governor for the filing of a federal bankruptcy petition.

# Selected Examples of the 50 State Survey

## Pennsylvania Notes (cont'd)

Pursuant to § 28211, a city of the second class is not authorized to file a federal bankruptcy petition unless (a) it has no bonds outstanding under the Pennsylvania Intergovernmental Cooperation Authority for Cities of the Second Class and (b) it has received approval from the governor for the filing of a federal bankruptcy petition. Pursuant to § 1773, a public transportation authority is not authorized to file a federal bankruptcy petition if such authority has outstanding any bonds issued pursuant to the chapter. See *also* 53 PA. STAT. ANN. § 101 (classification of cities).

With respect to the commonwealth's prohibition on Cities of the Third Class filing municipal bankruptcy petitions until July 1, 2012, see PA. ACT no. 26 (printer's no. 1452, signed into law by governor on June 30, 2011).

Of the five entities filing municipal bankruptcy petitions, three were cities or towns (specifically Harrisburg, a borough and a township) and two were special municipal districts.

ii PA. CONST. art. IX, § 10; PA. CONST. art. IX, § 12 (Philadelphia debt).

iii 53 PA. STAT. ANN. §§ 11701.101 to 11701.501. These provisions apply to any county, borough, incorporated town, township and home-rule municipality. Triggering events include the municipality maintaining a deficit over a three-year period, with a deficit of 1 percent or more in each of the previous fiscal years; expenditures exceeding revenues over a three-year period; defaulting on bond payments; missing payroll for 30 days; missing required payments to judgment creditors; failing to forward employee withholding taxes; accumulating a deficit in two successive years of 5 percent or more of its revenues; failing to make certain budgeted payments; attempting to negotiate and adjust a claim in excess of 30 percent against a fund or budget and failing in the negotiation; filing a municipal bankruptcy petition; or experiencing a decrease in a quantified level of municipal service from the preceding fiscal year, resulting in it reaching its legal limit in levying real estate taxes for general purposes. See 53 PA. STAT. ANN. §§ 11701.201.

There have been 26 filings under these provisions since 1987 and six rescissions of such filings. Examples of municipalities that were determined to be financially distressed include Pittsburgh in 2003 and the Borough of Wilkinsburg in 1988. See *Borough of Wilkinsburg v. Department of Community and Economic Development*, 728 A.2d 389 (Pa. Commw. Ct. 1999). Other cities include Farrell (1987); Aliquippa (1987); Clairton (1988); Borough of Braddock (1988); Borough of Franklin (1988); Borough of Rankin (1989); Duquesne (1991); Scranton (1992); Johnstown (1992); Borough of Millbourne (1993); Chester (1995); Borough of Greenville (1995); Borough of West Hazleton (2003); Township of Plymouth (2004); Nanticoke (2006); New Castle (2007); Westfall Township (2009); Reading (2009) and Harrisburg (2010). Distress determinations have been rescinded for certain cities including Wilkinsburg, Shenandoah, Ambridge, East Pittsburgh, North Braddock and Homestead. Pennsylvania Department of Community and Economic Affairs Distress Determinations, available at <http://www.newpa.com/get-local-gov-support/technical-assistance/request-assistance/act-47/index.aspx> (last visited July 15, 2011).

# Selected Examples of the 50 State Survey

## Pennsylvania Notes (cont'd)

Several cases have explored the interplay between Act 47 and collective bargaining agreements; see, e.g., *Wilkesburg Police Officers Ass'n v. Commonwealth*, 564 A.2d 1015 (Pa. Commw. Ct. 1989) (rejecting union argument that Act 47, by limiting prospective bargaining agreements, violates the constitution's requirement that municipalities engage in collective bargaining); *City of Farrell v. Fraternal Order of Police Lodge No. 34*, 645 A.2d 1294 (Pa. 1994) (upholding arbitrator's decision to increase union salaries despite challenge from the city, noting that the approved plan did not freeze or place limits on increases of police salaries, though it did prohibit increases in the cost of fringe benefits); *Pittsburgh Fire Fighters, Local No. 1 v. Yablonsky*, 867 A.2d 666 (Pa. Commw. Ct. 2005) (holding that § 252 of Act 47 applies to both arbitration settlements and arbitration determinations); *City of Scranton v. Fire Fighters Local Union No. 60*, 29 A.3d 773 (Pa. 2011) (finding that Act 47 does not impinge on arbitration awards under Pennsylvania's Policemen and Firemen Collective Bargaining Act with respect to employee bonuses, salary increases and health benefits).

At least one commentator has noted that an issue in applying Act 47 (the financially distressed municipalities provisions) is how to deal with collective bargaining after a financial distress declaration has been made. As it stands, the provisions prohibit financially distressed municipalities from entering into collective bargaining agreements conflicting with the plan. Unions argue that this is an impermissible restraint. See A.C. Schroeder, *The Interplay Between the Municipalities Financial Recovery Act and the Policemen and Firemen Collective Bargaining Act: an Analysis of City of Scranton v. Fire Fighters Local Union No. 60*, 19 WIDENER L.J. 541 (2010).

- iv 53 PA. STAT. ANN. § 12720.101 *et seq.* These provisions were created in 1991 to deal with issues faced by the City of Philadelphia. Philadelphia continues to be under the guidance of the Pennsylvania Intergovernmental Cooperation Authority.
- v See, e.g., 53 PA. STAT. ANN. §§ 8241-8251 (municipal refunding bonds generally). The state code may be more expansive with respect for refunding bond provisions related to various types of bond issuances, and an attorney should be consulted to examine any specific situation involving a default.
- vi See, e.g., 53 PA. STAT. ANN. § 15733 (revenue bonds issued by cities of the first class to construct sewer systems) and 53 PA. STAT. ANN. § 8264 (receiver for revenue projects). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether such a receiver may be appointed.

# Selected Examples of the 50 State Survey

## Pennsylvania Notes (cont'd)

- vii 53 PA. STAT. ANN. § 8263. On written request by bondholders holding 25 percent or more principal amount of bonds outstanding and on being furnished with indemnity, a trustee may: bring a writ of mandamus or other proceeding in equity to enforce the rights of bondholders to impose and collect rents, rates, tolls and charges adequate to carry out the agreement or carry out any other agreement with the bondholders; bring suit on the bonds; require an accounting from the local government; in the case of general obligation bonds and guaranteed revenue bonds, petition the court to levy, after a hearing and notice to real estate owners, the amount due before or after the exercise of any right to accelerate the bonds or notes, plus the estimated cost of collection; to seek an injunction; or after 30 days' prior written notice to the local government, and subject to the bond ordinance or relevant indenture, declare the unpaid principal and interest immediately due and payable.
- viii *See, e.g.*, 53 PA. STAT. ANN. § 12720.305 (Pennsylvania Intergovernmental Cooperation Authority for Cities of the First Class) and 53 PA. STAT. ANN. § 25687 (waterworks bonds). The state code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether a bondholder may bring an action for an accounting.
- ix *See, e.g.*, 53 PA. STAT. ANN. § 15733 (revenue bonds issued by cities of the first class to construct sewer systems); 53 PA. STAT. ANN. § 15920 (revenue bonds issued by cities of the first class); 53 PA. STAT. ANN. § 12720.305 (Pennsylvania Intergovernmental Cooperation Authority for Cities of the First Class); and 53 PA. STAT. ANN. § 25687 (waterworks bonds). It is possible that an aggrieved bondholder could pursue a writ of mandamus even absent authorizing statutory law.
- x *See, e.g.*, 53 PA. STAT. ANN. § 15907 (revenue bonds issued by cities of the first class shall contain a pledge and grant of security interest in project revenues). This is an example of a special revenue bond. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.

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